Journal of Research on Trade, Management and Economic Development
VOLUME 1, ISSUE 1/2014

MODELING OF ACCOUNTING ASPECTS OF FINANCIAL RESULTS

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Abstract

Modern trends in world economy require expanding functional informational capabilities of financial statements. Market-oriented users of financial statements are interested in information necessary when making decisions of financial character.

Keywords: *financial result (loss or profit), accounting and reporting, financial statement, regulatory documents of financial results.*

JEL classification: M41

1. Introduction

Modern trends in the world economy require expanding functional informational capabilities of financial statements. Market-oriented users of financial statements are interested in information necessary when making decisions of financial character. Thus, the most important aspect of business activity in any enterprise is the identification of financial results for a certain period. In general, accounting of financial results brings forward the following three components:

1) Reflection of data on income from economic and financial activities;

2) Merging of information about expenditures which contribute to obtaining these revenues;

3) Comparison of revenues and expenditures and determination of financial results.

A financial result (profit or loss) represents the absolute efficiency of company's management in all areas of its activity: production, sales, procurement and investment. It forms the basis of economic development of an enterprise and strengthens its financial relations with all members of the commercial business.

Profit is the most important economic category and the main goal of any industrial enterprise. As an economic category profit shows the net revenue generated by productive labor in the sphere of material production.

However, different users of accounting information are interested in certain aspects of financial accounting of financial results. In order to consider the most significant results we will generate a model for accounting financial results and with its help we shall define its components, nature and significance (Figure 1).

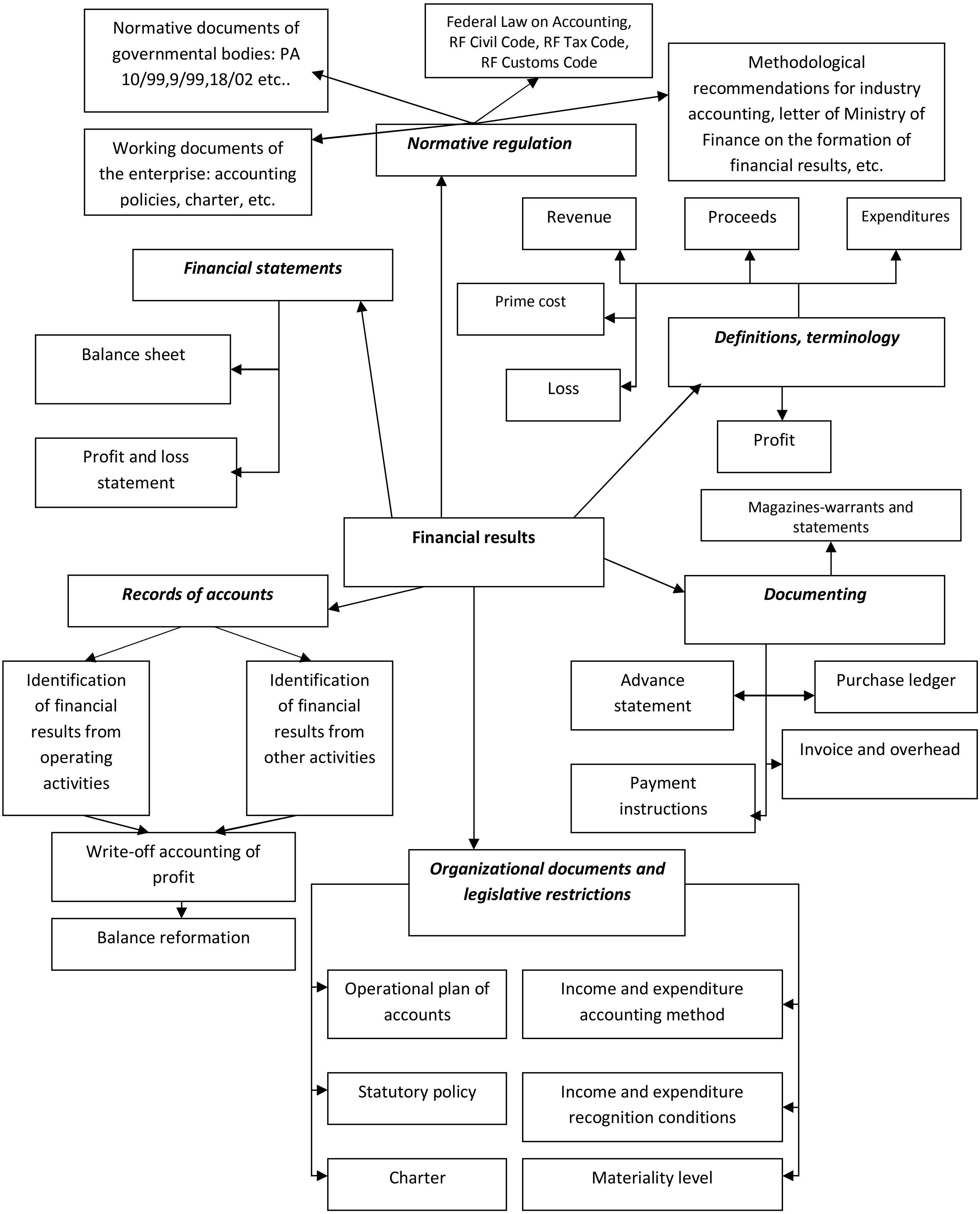

Figure1: Model representing aspects of financial results

In our opinion, examination of presented aspects is impossible without studying the unit of definitions used to describe financial accounting of financial results (Figure 2). Thus, we tried to make it more understandable by means of the following figure:

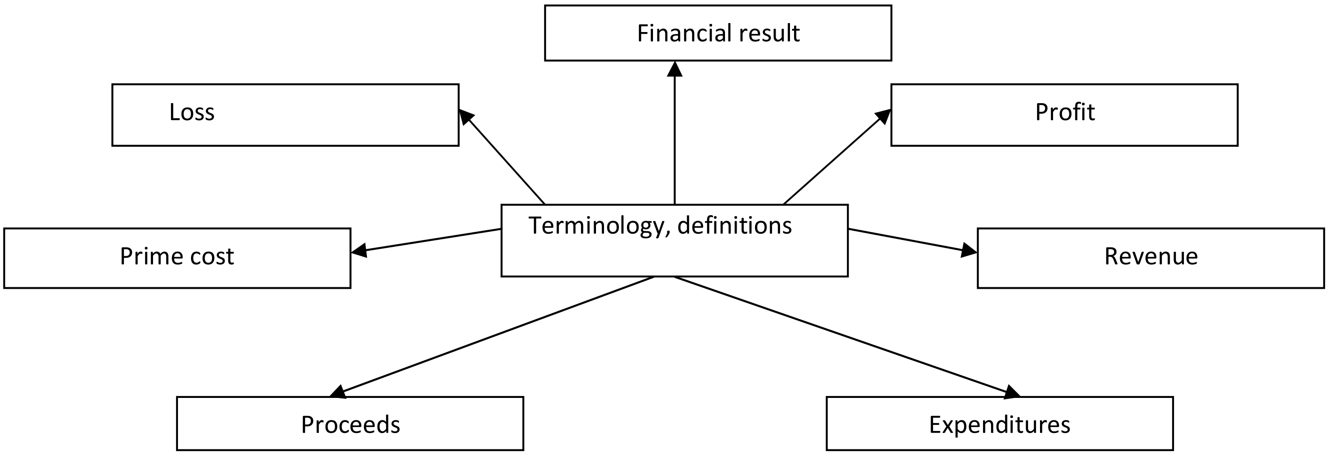

Figure 2: Terminology aspect of financial result in financial accounting

It is necessary to start with the definition of a financial result. In accounting and in economy as a whole there are many meanings of this term. Modern economic dictionary gives the following definition: a financial result is the result of company's economic activities and its subsidiaries expressed by financial indicators such as profit (loss), change in the cost of equity capital, receivables and payables, income.

Dictionary "Accounting, taxes, business law" gives the following interpretation: a financial result for a reporting period is recorded as undistributed profit (loss) – a final financial result revealed during the reporting period, less profit taxes and other similar payments established in accordance with the legislation of Russian Federation including sanctions for non-compliance to tax regulations.

The Dictionary of Financial Terms defines financial results as financial expression of economic results of the economic activity of the entire company or its subdivisions.

According to juridical literature, a financial result is an increase or decrease of company's capital in the process of its financial-economic activities occurred during the reporting period expressed as total profit or loss.

As mentioned above, there are many definitions of the financial result; however, there is also one important point: when forming the financial result in the accounting system it is acceptable to calculate a number of indicators characterizing organization's activities. The following categories are used as such indicators:
- Gross profit;
- Profit (loss) from sales (ordinary activities);
- Profit before taxation or accounting profit;
- Net profit (loss) for the accounting period.

Returning to the Modern Economic Dictionary, we present the given definition: Gross profit is the difference between revenues of an enterprise/entrepreneur from the sale of goods and the manufacturing cost of product before deducting income tax. If we consider the reflection of gross

profit in financial statements and its reflection in financial accounting, in this case the most meaningful and accurate definition is the following: gross profit is an indicator of loss and profit statement, defined as the difference between the data of the article “Revenue (net) from the sales of goods, work and services” (net of value added tax, excise duties and similar mandatory payments) and the data from item “Prime cost of the sold goods, products, work and services”.
The next stage of net profit formation is the determination of profit margin calculated by deducting commercial and administrative expenses from the resulting gross profit.

Accounting profit or profit before taxation is defined in many editions as enterprise’s profit before tax deduction. However, the following interpretation of this term will be most appropriate: profit before taxation is profit from sales taking into account other income and other incurred expenses. The list of income and other expenses from other activities is approved by PA 9/99 and PA 10/99.

Net profit is profit for the reporting period remaining after payment of income tax and other similar mandatory payments. A similar definition is given in the Modern Economic Dictionary: Net profit is the profit remaining at company’s disposal after deduction of taxes and other mandatory payments. Deducted taxes, deductions and mandatory payments include: income tax, penalties on budget and extra budgetary funds.

It is also necessary to define the term “loss”. Losses are considered to be the reduction of own capital resulting in the loss of own assets.

In civil law “los” is damage in a monetary form caused to a person by another person’s illegal actions. In juridical literature loss is understood, firstly, as expenses which the person, whose right is violated, made or will have to make in order to restore it, as well as loss or damage of property (real damage); secondly, “loss” is the revenue which the person would have received if an obligation was properly fulfilled by a debtor (not received profit).

In accordance with Modern Economic Dictionary, “loss” is defined either as loss of economic activities in terms of money or excess expenditure over income entailing reduction of material and financial resources.

It means that similar to profit, loss is a financial result of enterprise’s activities, but it’s opposite in value reflecting the inefficiency of company’s work. Moreover, taking into account the legal aspect, one can say that loss can be considered not only a result of activity, but also an event that may cause damage to an enterprise due to the fault of third parties or to its employees.

Further we will introduce a term without which it is impossible to define a financial result, either profit or loss. It is the prime cost of a product. Here can be distinguished a general definition used in most literature: prime cost of a product is a set of direct costs associated with production, or any costs incurred from the manufacture to the sale of a particular product.

And here comes a more complete definition: prime cost is cost estimation of natural resources, raw materials, fuel, energy, fixed assets, labor used in the process of producing goods (work, services) as well as other costs incurred for its production and sale.

According to PA 9/99, organization costs are considered the reduction of economic benefits arising from disposal of assets (cash or other property) and (or) incurrence of liabilities leading to reduction of company’s capital, except for the reduction of contributions decided by participants (property owners).

Next, we will consider the term "income". According to PA 10/99, company's income is recognized as increase of economic benefits as a result of assets volume growth (cash or other property) and (or) repayment of obligations leading to an increase of company's capital except for the contributions of participants (property owners).

Another aspect of financial result accounting is normative regulation of its formation, calculation, accounting and reporting (Figure 3).

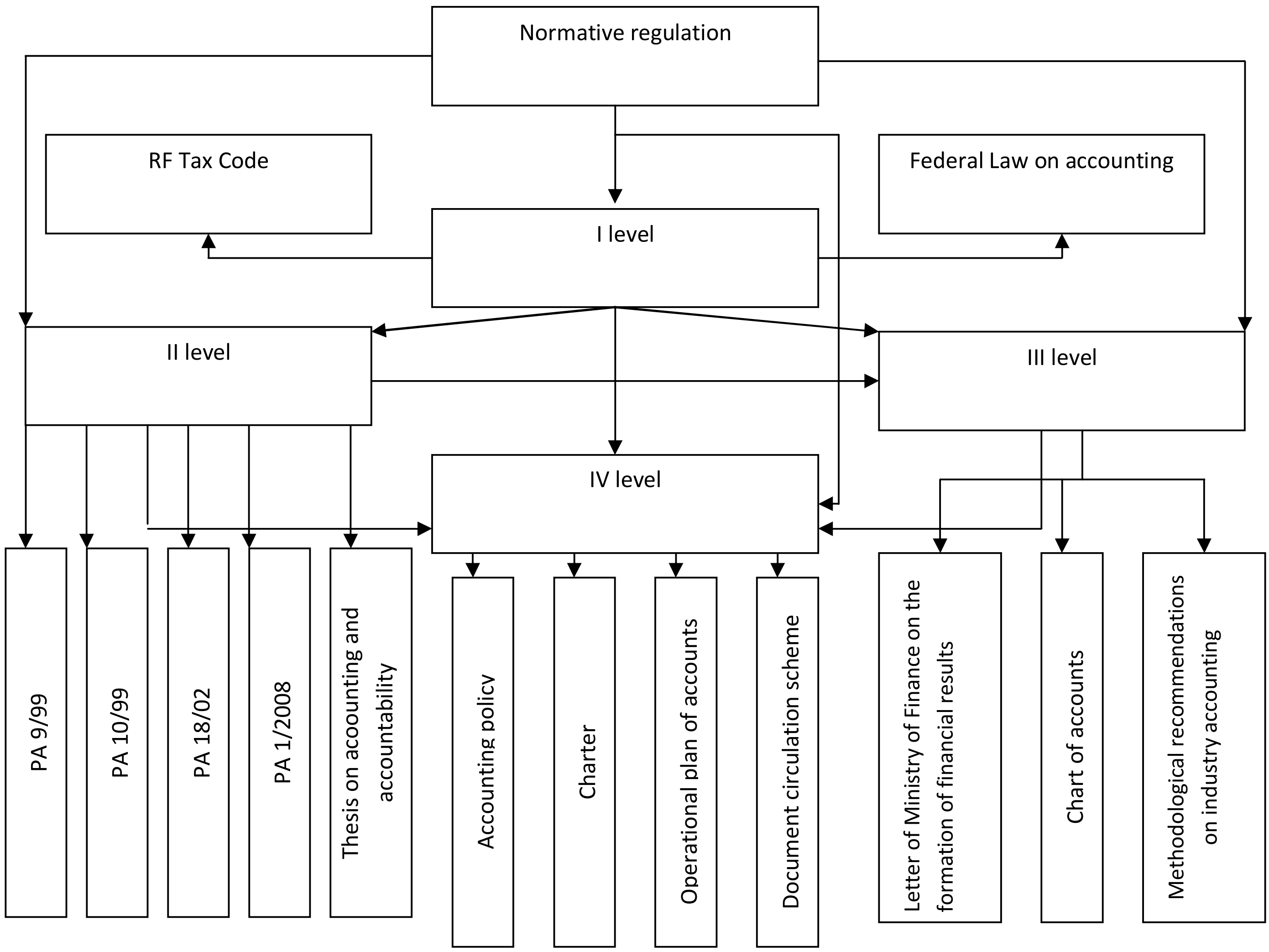

Figure 3: Normative regulation of financial result accounting

Our main task is to consider each level in more detail. The first level is mainly determined by the provisions of Federal Law on accounting No. 129-FL of 21.11.1996. Among these, directly related to financial results accounting, the following can be distinguished: order of income and expenses recognition for organizations applying different tax regimes, basic principles regarding reflection of financial results in reports, basic requirements toward constitution of primary documents and ledgers, establishment of common methodological management of accounting and the scope of various regulatory levels.

This level includes RF Tax Code, RF Civil Code and RF Customs Code establishing: rules for profit taxation, main provisions regarding the activity of organizations having various ownership forms, as well as responsibility for the performance of obligations under tax legislation and obligations of an enterprise before their employees having certain impact on the financial results of company's activities.

The next level includes regulatory documents issued by governmental bodies (Ministry of Finances, CB etc.). In terms of financial results formation the most significant are the following:

1. Provisions on accounting "Revenues of an organization" PA 9/99 and "Expenses of an organization" PA 10/99;

2. Provisions on "Income tax accounting" PA 18/02;

3. Provisions on "Accounting policy of the organization" PA 1/2008, which is an organizational document for a company containing certain restrictions on its activities;

4. Provisions on accounting and financial reporting in the Russian Federation which, similar to the Law on accounting, establish the basic requirements for conducting accounting of financial results and for their registration, as well as such provisions:

- Profit or loss identified in the reporting year but related to previous-year operations are included in the financial results of organization for the reporting year;

- Revenues received in the reporting period but related to future reporting periods are reflected in the balance sheet as a separate item as deferred revenues; these revenues should be classified as financial results in a commercial organization or as income increase of a non-profit organization occurring during reporting period to which they relate;

- In balance sheets the financial result of the reporting period is reflected as retained earnings (loss); in other words, this is the final financial result revealed for the reporting period less profit taxes and other similar mandatory payments established in accordance with the legislation of the Russian Federation including its provisions regarding non-compliance with tax rules.

The third level of normative regulation of financial results includes guidelines with regard to industry particularities, instructions on accounting procedures for various elements, including guidelines for the development of public accounting and auditing organizations. Third-level documents include: the letter of the Ministry of Finance about the formation of financial results, chart of accounts, instructions for using the chart of accounts when reflecting financial and economic activities of an organization, methodological recommendations (or guidelines) on industry accounting, complementing the regulatory framework established by higher-level documents and transferring them to the sector in which the company operates.

The last, fourth, level concerns organizational documents of an enterprise: accounting policy, charter, chart of accounts, etc., which define a set of rules which implementation will ensure the highest financial results accounted. The development and implementation of such rules are directly connected to company's practical accounting and its accounting methods.

Further, we will consider in more detail aspects of organizational documents and legislative restrictions regarding financial accounting of financial results (Figure 4).

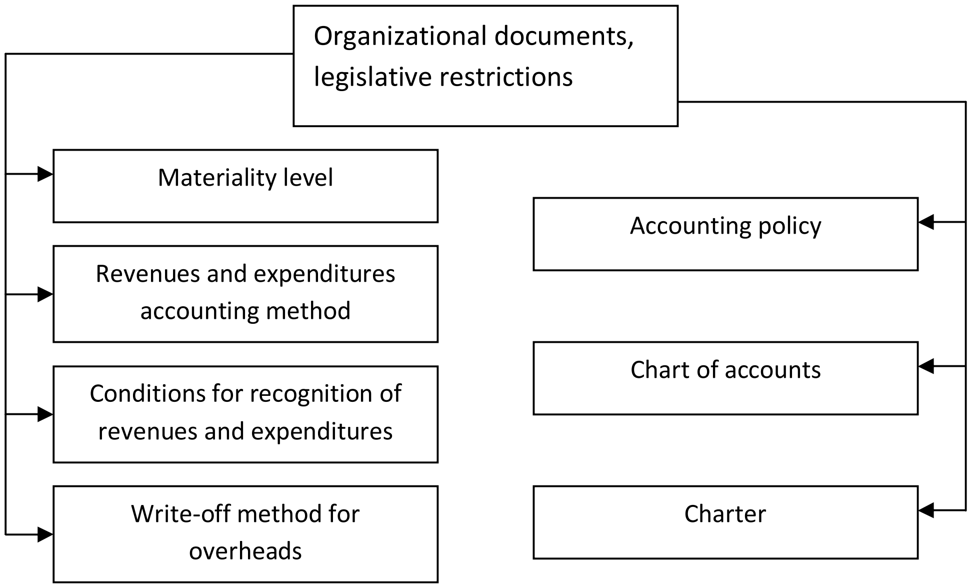

Figure 4: Organizational documents and legislative restrictions regarding financial accounting of financial results

I. Accounting policy. Its formation approach is approved by PA 1/2008. Among its provisions regarding financial results one can distinguish the disclosure of accounting methods significantly affecting evaluation and decision-making by interested users of financial statements.

Accounting methods are extremely important, without relevant knowledge regarding their application interested users will not be able to reliably estimate company's financial situation, financial results of its activity and (or) the cash flow.

Accounting methods, employed in the formation of accounting policy and subjected to disclosure in financial statement, include methods of depreciation of fixed assets, intangible and other assets; estimation of industrial stocks, goods, unfinished work and finished products; recognition of revenue from sales of products, goods, services and other methods.

Provisions characterizing financial result-related accounting methods may include:
- Revenues and expenditure accounting methods;
- Materiality level in accounting;
- Direct and indirect costs;
- Write-off method for overheads.

Revenues and expenditure accounting methods:
1. Accounting cash method, in terms of this method, the date of income receipt is considered to be the day when funds are received to bank accounts and (or) to the cashier, the same is true regarding the receipt of other property (work, services) and (or) property rights as well as repayment of debt owed to the taxpayer by another method (cash method).
Taxpayers' expenditures are recognized as costs after the actual payment; payment of goods (work, services and (or) property rights) is considered to be the termination of reciprocal obligation by a taxpayer – purchaser of goods (works, services) and property rights – to a seller directly connected to the supply of these goods (implementation of works, provision of services, transfer of property rights).

A company is entitled to apply the cash method only if its average amount of revenue from sales of goods for the previous four quarters (excluding VAT) does not exceed one million rubles.
2. Accrual method of accounting - the essence of this method is actually reduced to the fact that revenues are recognized regardless of cash, other assets (work, services) and (or) property rights receipt, and expenditures are accordingly recognized irrespective of their actual payment.

For proceeds from sales, unless something else is provided by article 271 of RF TC, the date of income receipt is considered to be the date of sale of goods (work, services, property rights), determined according to Article 39(1) of RF TC, regardless of the actual receipt of funds (other property (works, services) and (or) property rights).

With regard to non-operating income the dates for their recognition for tax purposes are established in accordance with Article 271(4) of RF TC.

Expenses are recognized in the reporting (tax) period in which these expenses arise from transactions. If a transaction does not contain such provisions and the relationship between revenues and expenditures cannot be clearly determined or is determined indirectly, the costs are allocated by a taxpayer independently.

If contract terms provide income generation for more than one reporting period and do not provide phased delivery of goods (works, services), the costs are allocated by taxpayer independently with regard to the principle of uniformity of revenues and expenditures recognition.

The structure of direct and indirect costs is determined by RF Tax Code and is fixed in the accounting policy of the company.

Conclusions

So, the financial results of accounting have been considered and treated from different points of view and different definitions were given. A model for accounting financial results was generated and its components, nature and significance defined. Terminology aspect of financial results in financial accounting was also shown. Another very important aspect of financial results accounting, the normative regulation regarding their formation, calculation, accounting and reporting was introduced and examined and also accompanied by a relevant figure. Organizational documents and legislative restrictions on financial accounting of financial results were also considered and thoroughly examined. Therefore, these findings can be of benefit for different types of organizations.

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