



THE ADAPTATION OF PROFIT AND LOSS ACCOUNT TO THE CURRENT REQUIREMENTS REPORTING OF THE PERFORMANCES

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Abstract

The financial performance – a very complex notion and high informational load for users of accounting information is reflected best by the financial statements, the profit and loss account and the situation of equity variations. The last situation can be presented as a statement of comprehensive income, including beside the result of profit and loss account, the gains and losses directly recognized in equities without passing through the profit and loss account.

The development of increasingly complex activities emphasizes the utility, the necessity of the profit and loss account in the financial reporting by increasing the interest in the enterprise performance, especially for the dynamic information that this situation can provide.

Meanwhile, there is a declining interest in the historical costs and static information. Although the balance sheet contains information on performance, it does not prevent the achievement of its forecasts.

In this paper we propose to approach the profit and loss account in view of two representative referential, namely in terms of IAS 1 standard “The preparation and presentation of the financial statements” and the national regulation, the Finance Order no. 1802/2014 regarding the Approval of the Accounting Regulations on the annual individual and consolidated financial statements, aiming to emphasize the advantages, but also the limits provided by this models. This way, will see which of these models of profit and loss account respond best to users’ needs.

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Introduction

The development of increasingly complex activities emphasizes the utility, the necessity of the profit and loss account in the financial reporting by increasing the interest in the enterprise performance, especially for the dynamic information that this situation can provide.

The information regarding the performance of an enterprise, especially its profitability, helps to assess the potential changes of economic resources that the enterprise can control in the future. In addition, they are used to anticipate the enterprise capacity to generate future cash flows with the existing resources. The same information is useful for formulating and reasoning the efficiency of the enterprise to procure new resources.

The concept of “performance” is differently interpreted by the users of accounting information, depending on their interests. Thus, the managers are interested in the substantiation of decisions on overall performance, the investors are especially interested in the profitability of their investments, the employees are interested in the stability and profitability of the enterprise, and the creditors are interested in the solvency and company’s ability to pay debts according to schedule. We can say that measuring the activity of an enterprise’s financial performance is based on the user’s objectives.

The result of the financial exercise, expressed in the profit and loss account, is commonly used as a measure for assessing the activity of an enterprise’s financial performance.

In addition, the profit and loss account provides the essential information in the forecasting of the enterprise’s capability to generate future cash flows.

A question that can be made is how the information contained on this situation can help users in predicting future cash flows, knowing that this situation provides information to assess the past performance of the enterprise. The substantiation of the response is based on the following



thinking, a positive past performance is not an absolute guarantee of a desired positive development, but the analysis can trace the future evolution trend of enterprise' activity, within certain margin of risk. Moreover, the profit and loss account helps users in determining the risk or the uncertainty level regarding the future cash flows.

However, the results from accounting are the consequences of applying series of postulates, principles, independence of financial exercises and connection of expenses to incomes that is why this synthesis document must be treated with a dose of prudence.

Literature Review

Research theme responds the current needs in the area of non-financial reporting.

I studied current legislation and the latest works in the area. It is a topical issue and of great interest.

1. Ways of presenting income and expenses offered by IAS 1 "Presentation of Financial Statements"

The conceptual framework of international accounting in connection with the profit and loss account defines and characterizes the elements that describe the enterprise's financial performance, namely: the incomes and the expenses.

The definitions proposed by the IASB accounting framework for revenues and expenditures are very comprehensive, they refer to both incomes/expenditures incurred in the normal course of activities and to gains/losses, ups/downs of securities that can occur during the accounting period, whether are latent or realized.

The revised IAS 1 offers to entities two versions (options) to present all the items of incomes and expenses (including those directly affected by the equity), namely:

- to be presented *in one unique* financial situation called *The statement of the comprehensive income*;
- to be presented *in two* financial statements: *The profit and loss account* and *The statement of the comprehensive income*.

The statement of the comprehensive income should be given separate headings: *The profit or loss account* and *Other elements of the comprehensive income*.

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The section *Other elements of the comprehensive income* comprises:

- the variation of the reserve re-evaluation after the assets revaluation (falling under the incidence of IAS 16 and IAS 38);
- the gains and losses from the revaluation of the financial assets measured at fair value (falling under the incidence of IAS 39);
- the gains and losses from the evaluation of instruments used to cover the risks of cash flows (falling under the incidence of IAS 39);
- the gains and losses arising from the conversion of the financial statements of abroad operations (IAS 21) etc.

From the financial analysis of the three situations listed above, the last two cases are obtained by separating the first financial statements “The statement of comprehensive income as a unique situation” in two distinct situations: “The profit and loss account” and “The statement of the comprehensive income”, keeping the order of the headings. The idea is to distinguish a situation that shows the elements which directly contributed to the acquirement of profit or loss, called “The profit and loss account”.

Moreover, “The profit and loss account” should present different the profit or loss obtained under conditions of normal activity from the profit or loss derived from uncertain or discontinuous operations.

It is interesting to analyze the first part of “The comprehensive income as a unique situation” called profit or loss. Thus, the IAS 1 enables enterprise to decide on the structure and content of the revenues and expenditures reported in profit or loss, offering this way a minimal list of items that must be listed. The enterprises have the freedom to choose between a presentation of expenses by nature or by function, but they must be very careful in their choosing not to distort the financial performance of the activity.

The international standard IAS 1 does not propose a rigid structure of the profit and loss account, but encourages the exercise of professional reasoning in assessing the significance of an item of income or expense. If they are significant, the elements are presented separately, depending on the nature or importance.

The costs and revenues, analyzed by their nature separate into operating expenses and incomes and financial expenses and incomes.

The category of operating expenses and revenues includes those incurred in: obtaining production, the sale of stocks, the provided services, other expenses and incomes such as donations, compensations, subsidies, costs and incomes from the assets adjustment in order to present their non-financial debt in the balance sheet, gains and losses from sales of tangible and intangible assets, etc.

In addition, in the financial revenues and expenditures category we can mention the interests, incomes from securities held in associated companies, expenditures and revenues from adjustments of assets and financial liabilities in order to present them into the balance sheet, gains and losses from sales of financial assets, the differences from exchange rate, etc.

The operating and financial revenues and expenses are considered ordinary because they are quite common and occur during the normal activity of the enterprise.

Next we will analyze the profit or loss of the financial exercise – under the vision of the international standard IAS 1 by two methods: the classification of expenditures both by nature and by their functions. We highlight the benefits and limitations of each method.

Table no. 1. The profit or loss of the financial exercise – under the vision of the international standard IAS 1

The profit or loss of the exercise, with the classification of the expenses by nature	The profit or loss of the exercise, with the classification of the expenses by function
Incomes	Incomes
Other incomes	Cost of sales
The stocks variation	The gross margin
Immobilized production	Other incomes
Consumption of raw materials and consumables	Distribution costs
Personnel expenses	Administrative expenses
Expenses regarding the depreciation	Other expenses
The corporal immobilizations	The financing costs
depreciation	The percent of profit of associated enterprise

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Other expenses	The profit before taxation
The financing costs	Income tax expenses
The percent of profit of associated enterprise	Profit or loss from continuing activities
The profit before taxation	Profit or loss from discontinuous activities
Income tax expenses	The profit or loss of the exercise
Profit or loss from continuing activities	
Profit or loss from discontinuous activities	
The profit or loss of the exercise	

Source: www.iasplus.com/en/standards/ias/ias1

The advantages of using the method of classification of expenses by nature:

- allows the use of profit and loss account in the calculation of intermediate balances, allows macroeconomic aggregate calculations;
- the information from the classification of expenses by nature is useful in the estimation of the future cash flows for the enterprise;
- this method is easy to apply because it does not require the allocation of operating expenses on functional classification. This model is suitable to the needs of small and medium-sized enterprises or to the large ones that do not exceed certain thresholds of indicators used in European boundaries: the turnover, the total assets and the number of employees;
- this method provides more objective and verifiable information;
- facilitates the cash flow projections.

The disadvantages (limits) of this method:

- this model does not say anything about the performance of the management in achieving the enterprise functions.

If we analyze the scheme of profit or loss of the exercise *with the classification of expenses by function*, is seen that the revenue item represents the turnover. By lowering the cost of sales from the income (the turnover), the gross profit indicator is obtained, which in fact is the gross margin on cost of sales.



The cost of sales includes all costs for supplies, services provided by third parties, labour, rent and depreciation expense used in the manufacturing process of goods.

The cost of an inventory item does not include the sales and administrative expenses. So the sale cost does not include the distribution and administration expenses.

The distribution costs refer to expenses incurred in the promotion and distribution of the goods, sold by the company. (Marketing costs, staff costs used in the distribution of products, depreciation, rent space with commercial destination).

The IAS 1 standard requires the companies that use the method of classification by function to present additional information about the nature of expenses, including the depreciation and personnel expenses.

The advantages of using the method of classification of expenditure by their functions:

- this presentation often provides more relevant information to users than the classification of expenses by nature, but the allocation of costs by functions can be often arbitrary and involves considerable professional reasoning;

- this model of analysis offers information on performance management regarding the business, the distribution and administration functions, so it is more relevant in the analysis of the financial performance than the other models which says almost nothing about the performance of enterprise;

- the presentation of expenses by function permits the determination of the gross margin as a difference between the turnover and the cost of sold goods or provided services. These indicators provide important information used in the comparison of the enterprise efficiency.

The limits of the method:

- this model, even more relevant in the analysis of the financial performance, is less reliable, because the allocation of costs depends on how the enterprise management defines its function. Moreover, if managers make organizational changes and adjust the functions, then the information cannot be compared over time;

– does not allow the forecast for the future cash flows. Therefore, IAS 1 requires companies to present the additional information on the nature of expenses, including the expenses with depreciation and personnel.

2. Ways of presenting income and expenses offered by Finance Order no. 1802/ 2014 regarding the Approval of the Accounting Regulations on the annual individual and consolidated financial statements

Next, we will analyze the Profit and loss account – from the national regulation, *the Finance Order no. 1802/2014 regarding the Approval of the Accounting Regulations on the annual individual and consolidated financial statements* point of view – by presenting it as a list form with the classification of the expenditures and incomes by nature, presenting the advantages and limits.

Table no. 2. The profit or loss of the financial exercise – under the vision of the national regulation

The simplified form list of the profit and loss account, with the classification of the expenditures by their nature
The net turnover
The stocks variation of the finished goods and the production in progress
The exercise production
Other operating incomes
Operating expenditures
Adjustments of value of the tangible, intangible immobilizations and circulating assets
Other operating expenditures
Incomes from participating interest, from other investments, and loans
Receivable interests and other similar incomes
Payable interests and other similar expenditures
Profit/loss of the current activity
Income tax
The result of the financial exercise

Source: Finance Order no. 1802/2014 with subsequent amendments



The model of the profit and loss account with the classification of expenses by nature has the advantage that the financial analyst can study the consumption of inputs, by reporting various expenses classified by nature in the production of the exercise. In this way it can be established the wealth created by the enterprise expressed through the added value and the way this wealth is distributed.

The added value expresses the growth of value that results from the use of production factors, especially labour and capital factors, over the amount of raw materials, the purchased materials and services from other enterprise, so the added value represents the wealth created by the enterprise by exploiting the technical, human and financial resources of other companies. This indicator expresses the contribution of the company in the production of goods and services, allowing the assessment of the degree of integration as a ratio between the added value and the turnover, and provides information about the progress or the regress of the company's activities.

The profit and loss account divided by the classification of expenses and incomes by their nature presents particular interest for the government and its organs. They require information to regulate the enterprise activities, to determine the fiscal policy, but also to calculate the national product, the national income, and other similar indicators.

This model shows a number of features and compatibilities between national accounts and enterprise accounts.

Conclusions

In conclusion, in order to answer to all the demands of today's global information regarding the result, but also to the information about nature and destinations of expenses, it is necessary a *Situation of the integrated performance* of the enterprise.

This situation must satisfy many requirements of the necessity of information on performance, namely:

- the single statement of financial performance should be divided into three components: the results of operational activities; the results of financial activities and other treasury activities; other gains and losses;

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- the continuing operations results should be separated from the staple ones, detailed reporting on the outcome of continue operations and staple operations;
- the presentation of cost classification by function, as well as by nature;
- the changes in the accounting policy should be reported and retroactively apply the new policy;
- the report of all changes in the results generated by the transactions and events relating to the business;
- the calculation and presentation of the indicator “Earnings per share”.

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