

THE IMPORTANCE OF ACCOUNTING INFORMATION IN CRISIS TIMES

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ABSTRACT: This paper tries to find in what way the accounting information can help economic entities in dealing with crisis. In order to answer this question we start by presenting the type of crisis we are dealing with at present, the causes and the effects on the international and national economic situation generally and the effects on the companies, particularly. We move on by presenting the role of accounting in supplying public and private information for those interested and by showing how can this information be used to limit the effects of the crisis and even to overcome it.

Key words: crisis, accounting, information, costs.

JEL codes for the paper: M41 Accounting

The financial crisis. Causes and effects.

The existing financial crisis has started at the beginning of 2007 in United State of America and gradually expanded to the entire world economy. We could definitely say that we are involved in the biggest crisis over the last 80 years and its end is hard to predict.

The main cause of this crisis is considered to be the American mortgage system which failed under its own weight, when people became seriously in dept and could no longer pay of their loans.

The story of this crisis is told in a very relevant approach by Bogdan Glăvan, in one of his articles⁴. The problem, according to that, started in 2000 when the USA Federal Reserve (FED) decided to drop the interest rate by monetary issuing. By the end of the year the interest rate has dropped from 6.25% to 1.75%, and reached 1% by 2003, this level being then maintained for a year. While prices were raising the actual interest rate was less than 0%, which meant the banks were paid to release money in economy. Similar politics were also adopted by Japan, United Kingdom and by the European Central Bank, which reduced the interest rate to about 2%, where it kept it for almost 4 years. A part of these cheap money released by the central banks were invested in their own economies creating a real estate boom and a speculative bubble as it happened in USA and other European countries. As the cost of money was low, people and companies were encouraged by the system to indebt themselves and the banks ended up with huge amounts of money immobilized in real estate assets – a good business as long as the market was blooming. But this blooming was an artificial one created by the expansion of the loans which allowed people to spend now their future earnings. We could name this situation “consumption anticipation”.

As the central bank is the one who leads and supervises the banking and monetary system, it decides whether to increase or decrease the amount of money from economy according to its political interests. “*Printing money costs the central bank – nothing, so it becomes easy for state to*

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⁴ Bogdan Glăvan, 7 April, 2009. Economical Crisis, available on-line at <http://www.logec.ro/criza-economica/>

*adopt a “too big to fail” policy by which the banks and other important financial actors are encouraged to indebt and invest imprudently. If these investments bring profits, the money goes into the bankers and other financial players’ pockets, and if the investments are unprofitable, the loss is externalized by inflation”.*⁵ State saves banks from bankruptcy by printing the necessary money to cover the loss and as long as the loss can be placed on the state, banks are no more interested in creating reserves or prudent investments. State offers a safety net not only for the financial actors, but for their clients also, by different government regulation as guarantying deposits. The state intervention in the financial system, as it has been done, replaces the private liability by public liability, as the possible loss is shared between state and investors.

The mortgage crisis and the bursting of other real estate bubbles around the world have led to recession in the U.S. and a number of other countries in late 2008 and 2009. In this crisis context all the economies are trying to limit the effects of their ignorance by different government regulations.

In Romania the financial crisis is pre-eminently an internal crisis created by the mix of the macroeconomic policies adopted in the last few years. The economic growth achieved in the period before crisis has been based on an anticipated consumption (people spending their future revenues). In the conditions of economic growth the Romanian government made a strategic mistake. It practiced a poor administration of the public money and increased the public debt from 1.2% of GDP in 2004 to almost 5% of GDP in 2008⁶, which also increased the costs of short term financing needed to cover the budgetary deficit.

From a microeconomic perspective firms and companies have been strongly affected by the sudden increased price of the capital. The increased costs of the contracted loans press on the businesses, affecting their productivity. The general context of the crisis affecting the public and private economy combined with population low buying power resulted into an economic disaster. To survive in this situation companies have to produce quality at low prices. Many of them adopted measures in order to reorganize their activities and reduce costs.

As the state needed more money to sustain public services and social programs, facing a rise of unemployment rate, government adopted a series of measures in order to ameliorate the economic situation. One of them was to modify the profits taxation. All the companies have to pay now a minimum tax which differs on turnover’s levels, whether they obtain profit or not. The immediate effects of this flat – rate tax was that many small firms closed down or suspended their activity. This tax has been introduced since May 2009. The next table (Table nr.1) presents in comparison the situation of companies closing down, or suspending activity, for the same period of 2008 and 2009.

⁵ Ibid note 4

⁶ www.mfinante.ro –site of Ministry of Public Finance

Table no. 1

Indicators	Suspended activity	Voluntary liquidation	Voluntary eraser
01.04.2008-27.04.2008	993	258	590
01.04.2009-27.04.2009	3424	556	1783
28.04.2008-30.04.2008	62	47	221
28.04.2009-30.04.2009	10611	1013	486
Total April 2008	1055	305	811
Total April 2009	14035	1569	2269
2009 against 2008	1330,33%	514,43%	279,78%

Source of data: The National Trade Registration Office, www.onrc.ro

As we have already mentioned the companies are facing a general disturbed economy, higher costs of already borrowed loans and a very impoverished market, with a low purchasing power. To survive they have to quickly adapt to these crisis conditions.

The role of accounting

At first sight accounting could seem a static instrument of recording data, which can only provide information about the state and the problems existing into an economic entity or public institution, but without providing solutions for them.

However it is important to remember that the first step of solving a problem is to be aware of the situation and to know its details. The information provided by the accounting records and financial statements take us to the root of the problems, helping the company to eradicate the causes and not only to repair the effects.

The main role of the accounting is to provide information for those interested whether they are a part of the economic entity or outside users.

Accounting provides two types of information:

- Public information – usually presented into the financial statements. This information is usually intended for outside users as shareholders, investors, banks and other financial organizations, state authorities and public institutions, business partners etc.
- Private information – intended for internal use, used in the decisional process.

According to the law nr.82/1991 accounting is “an activity specialized in measurement, evaluation, knowledge, management and control of assets, liabilities and equity, and the results obtained from the activity of legal and natural persons, it must provide chronological and systematic recording, processing, publication and preservation of information on financial position, financial performance and cash flows, both for their internal requirements, and in relations with current and potential investors, financial and commercial creditors, customers, public institutions and other users.⁷”

Accounting differs according to the current organizational scheme of normative acts resulting in:

- Financial accounting or general
- Management or cost accounting.

⁷ Law of accounting nr.82/1991, republished in M.O. nr. 454 / 18.06.2008

Financial accounting is to reflect the wealth of enterprises and the results of its movement and transformation.

The management accounting is a dynamic part of accounting, which is always in search of solutions to reduce costs and better the management of resources owned by the enterprise in order to improve the results of its activity. It can be defined as having objective the reflection of all the operations of collection and distribution of expenditures on destinations, respectively, products, works, services, orders, manufacturing phases, activities, departments, settlement of the obtained production and the calculation of the cost of manufactured products, of the work performed and services rendered.

Financial accounting provides information mainly on the financial position, financial performance and position changes, while management accounting provides information on costs and results of various activities, budgeting of the internal activity, deviations of actual costs from preset costs, etc. All these information will be processed and used by company management to improve the activity and grow performance.

Financial accounting is today regulated normalized and controlled, which makes accounting a powerful tool in the hands of the business leader. It is a system, which adapted to the information needs of the enterprise, can provide accurate and useful transmission of quality information. When it comes to financial accounting and management accounting, we should understand that we are not talking about two different accountings. They are two components of the same information system, the accounting one. Financial accounting does not reflect what is happening in production, providing information for external users. Management accounting, on the other hand, does reflect the production process, providing information for internal users.

The Romanian teacher Teodor Stefanescu said about accounting that "*Order is the light. Where funds are managed without accounting, which is nothing but the science of order, there is only darkness*".⁸ These words underline the indispensability of this science to effectively manage the resources of a company. Accounting is therefore intended to bring light. It presents the state of the company's patrimony, its financial state and the results of the activity developed by this.

The importance of accounting is given by the many functions that it meets both in the process of knowing the state of the enterprise at a given time, and in decision-making and forecast processes, necessary for planning and organizing future work in order to achieve the set objectives of the company and to improve the results of its activity.

The specialty literature attests the next accounting functions⁹:

- the function of recording and processing data
- function of providing information
- control function manager
- legal Function
- forecast function

First of all accounting performs the functions of recording and processing data, which means recording in special registers all the operations with economic content which are based on a supporting document, respecting the principles of accounting and legal rules in force. By this function an important database is created, whose structure must be characterized by order, precision and clarity.

Another function of accounting is the function of providing information. Accounting provides information on the structure and dynamics of the company's wealth, financial position and results. Accounting information provided is intended for both internal and external users. The company's management, which represents the internal users, needs accounting information to base decisions and long and short term strategies, necessary to achieve their objectives.

⁸ Bogdan, Victoria, "Contemporary accountancy basics", University of Oradea Printing house, 2005, pg. 3

⁹ after http://ro.wikipedia.org/wiki/Contabilitate#Func.C5.A3iile_contabilit.C4.83.C5.A3ii

The introduction of new communication technologies allows transfer of information on other channels than the written form (Internet, database, green phone). Green phone free call can work permanently or temporarily, providing information to external users. The Internet is information medium providing information directly, in short time and inexpensive¹⁰. Free access to information leads to an increased role and importance of the enterprise, increases the interest shown by external users of information, assures a better knowledge of the documents addressed to them and improves information. However it is transmitted, accounting information must be the basis for the decision-making process, optimal decisions being needed for maintaining the company among companies recognized on the market.

In the current crisis conditions is very important to closely monitor the relationships with third parties, whether they are debtors or creditors and expand the accounting analysis over them. Analysis of debtors and especially of the clients must follow the primary steps to determine their financial stability and the ability to pay their debts in order to decide the continuation or hinder of the economic relations with them. Analysis of creditors must take into account the retention of debt, the possibility to delay payments and the fluctuations of costs, in particular regarding the loans, as this financial crisis brought a growth of the costs of capital. As more companies lack liquidity, economic analysis of these two categories is absolutely necessary, as a company's incapability of payment may lead to chain collapse of several companies in economic relations with the former.

Another function of accounting is the control manager, which includes checking on how material and financial values of a company are stored, used and managed in comparison with the information provided by the accounting records. By exercising control function the company tries to discover factual inconsistencies between the real stock and the script one in order to correct them and protect the integrity of the company's patrimony.

The accounting records of the economic and financial operations, and the supporting documents can be used in the underlying litigation cases as evidence in court to prove the reality of those operations and to establish liability for patrimonial damages. Accounting for this effect, accomplishes a judicial function.

One of the most important functions of accounting is the function of forecast. This includes determining the evolution trends of future economic phenomena and processes based on accounting information relating to a period of time concluded. In times of crisis characterized by economic and financial instability is extremely difficult to make forecasts or estimates, but at the same time very important. Problems, arising from the effects of the crisis, affect the whole economic system: the market - by reducing the purchasing power of customers, the company and its business partners.

To achieve a realistic forecast the next elements must be considered: the accounting information relating to the company, the accounting information provided by third parties on their financial situation, and in a very great extent the country's political situation and governmental policies adopted.

In full period of crisis, leading the cost accounting is a strong argument to overcome it. Cost accounting is the most important source of information, showing important aspects of the economic activity of an economic entity, but also important aspects of the national economy. Keeping cost accounts means having information that gives power to the right decisions, tailored to the needs of internal users.

That management or cost accounting is a source of information, it is well known. But information has no value unless it contributes to reducing the uncertainty of future events. It should and can contribute to change the consequences of some decisions.

Cost accounting is aimed at providing information to managers both in matters of planning and organizing work and in final phase, that of controlling economic activity.

¹⁰ Minu, Mihaela, "Accountancy as an instrument of power" Economic Printing House, Bucharest, 2002, pg. 182

Although the financial crisis, planning can be done strategically, activities less affected by crisis can be planned as other useful activities for exceeding it easier. The company can plan commercial and pricing policies appropriate for the market situation. Managers know due to accounting information, which is the power of their company, can compare it with what is happening in the market and the decisions can be taken accordingly.

Also, the control of the business should not be set aside or marginalized. To control how and to what extent were the taken decisions respected, targets achieved, is to be responsible and capable. Control cannot be made without the information given by the two basic aid of the manager: financial accounting and cost accounting.

Finally, a trade credit policy to stimulate payment before due time and closely monitored the collection of receivables is very important. When the money invested is controlled by destination criteria and the investment circuit is being watched with professionalism, only then we can make the company to be recognized and accepted by the market as an equal partner.

Accounting information is useful to each manager, but only if it is closely analyzed. It can be the manager's best friend, even in crisis. Accounting information is a friend who offers a lot without asking much. However, it is important to follow the accounting principles for the information provided by accounting to be accurate and useful.

Conclusions and recommendations

In the context of the current financial crisis which generated an economic recession, companies should pay more attention to the accounting information and explore all the possibilities to assure their survival and economic stability.

In times of crisis is vital for a company to have a good degree of organization in the accounting department and to work with skilled accountants. The role of accountants is not just about recording and systematizing data in accounting, but also the interpretation of accounting information and to provide practical solutions to reduce costs and streamline business activities.

The economic instability makes necessary a tighter control over all economic operations, a responsible management of all resources, to filter and reduce as much as possible the costs and adapt the existing strategies to the new market conditions. Moreover, a company's success lies in its ability to use the information on time, be it accounting or other nature, and the ability to adapt to the market dynamics. In times of crisis and economic instability, the time that management has for making certain decisions can be extremely short, and those decisions- vital. What remains to be done in such cases can be summarized in the words of Theodore Roosevelt: *"Do what you can, with what you have, where you are."* As a company, you should do your best with the resources you have in the existing economic and market conditions, but decide what you can and find what you have using the accounting information.

The accounts reflect the effects of the decisions and practices adopted and implemented on any level within the company and therefore more attention should be paid to accounting information. Accounting is in this sense a kind of barometer of the changes made both internally, within the company, through changes in policies and strategies adopted, as well as externally, related to the economic environment, where it develops its activity. It is therefore very important that the company management to give importance to accounting information and try to find solutions on problems it faces.

In order to determine problems and find solutions the next issues should be considered by the company's management:

- Monitor relationships with third parties in order to determine the degree of confidence that can be granted, depending on their financial status and ability to pay.
- Attempt to recover claims from clients and debtors affected by the economic recession.

- Renegotiation of payment terms to suppliers and prioritize them on payment according to the impact that the interruption of business activity with them would have.
- Finding the necessary resources to pay the suppliers and creditors, to avoid additional expenditure as penalties or lawsuits in court.
- Refinancing the existing loans at lower costs if possible.
- Substantiation of decisions on accounting information and external environmental information.
- Reduce costs and streamline the production processes.
- Restructuring the company both in terms of personnel, and in respect of processes and activities.
- Resize activity if needed and careful allocation of resources.

With a professional accountant at the helm of accounting, compliance with accounting principles, leading financial and cost accounting properly, orderly, responsible and legally, any crisis can be overcome. The information that can pass companies easier through crisis may be received without delay. It all depends on how this information is used by the management team. The value of the accounting information depends on the optimal decision taken on that basis. This value differs from one information system to another, and so is the cost of the information.

Accounting information may be diverted due to failure of accounting documents to take account of all economic events within the company, if it is presented by applying strictly accounting principles or changing the assessment and work methods during the financial year. Strict application without judgment makes certain accounting estimates to have an approximate character, being the result of a mixture of accounting methods¹¹.

Information is worthy of interest to the user if permits and promotes decision-making, clarifies the uncertainty over the future of the entity and facilitates the achieving of forecasted earnings.

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