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INFORMATION FROM THE BALANCE SHEET IN THE FUNCTION OF THE MANAGERIAL ACCOUNTING

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Abstract

The relation between the accounting and the management is through the controllers or controlling process.This study has to show the relationship between specific figures on the financial statements and helps explain the significance of those figures. A balance sheet is a snapshot of what a business owns (assets) and owes (liabilities) at a specific point in time. Analysing a profit and loss statement and balance sheet it is important to set aside time each month to analyse your financial statements, to enable you to control and improve your business. By analyzing financial reports, the managers controll their business.

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Introductory observations

There was an underestimation of the balance sheet until recently, up until the users of the information relevant to the business did not understand the necessity of its preparation.

In fact, the balance sheet aims to provide data and information for the transactions of the entities in relation to the assets and sources of the assets, which are under direct control of the management of the enterprises. Shortly, the balance sheet represents **an image** of the balance of the assets, the liabilities and the capital of the enterprise at one point of its existence.

When we say "image", it means that the balance sheet reflects the state of the enterprise at a particular moment, just as the camera makes a picture of a particular situation. In fact, neither in the previous nor in the following moment, the state of the enterprise is the same as at the time of the preparation of the balance sheet. That particular moment for which the balance sheet is prepared can be any moment of its existence.

Usually, and in accordance with the legal regulations and the international financial reporting standards, the enterprises are obliged to prepare balance sheet at the end of the year, i.e. on the December 31st, as part of the annual account. In addition, the balance sheet is prepared in particular situations, such as merging or separating the company - **a division balance**, in bankruptcy or liquidation, but also whenever it is needed.(Arsov, 2008 , p. 20)

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Balance sheet report

The main feature of the balance sheet is the balance between both sides, assets and liabilities. From the Fundamentals of accounting we know that the asset contains the means, and the liabilities are the sources of the means. In relation to this, we will present this withthe following equation:

ASSETS = LIABILITIES, i.e.MEANS = OBLIGATIONS

This equation shows that there is *balance*t hat must exist at any moment and which derives from the character of the double bookkeeping itself. As a matter of fact, the simplicity itself of the equation shows that in order for an enterprise to function, it must have assets, and in order to provide these assets, it must use appropriate financial sources in the same total amount.

Taking into consideration the fact that the liabilities are consisted of the capital of the enterprise itself (shareholders' capital and accumulated profit) and liabilities (long-term and short-term), the equation could be developed in the following form:

ASSETS = OWN CAPITAL + ACCOUNTS PAYABLE

as well as

OWN CAPITAL = ACTIVE –ACCOUNTS PAYABLE

From the last equation it can be noted that if the management determines a situation in which the enterprise expresses greater liabilities, i.e. theliabilities exceed the value of the assets of the enterprise, then we can conclude that the value of the own capital is "decreased". This is due to the reason that the payment of liabilities has priority over the demands of the owners of the capital, so that if the enterprise operates at a loss, its own capital will be reduced, until its disappearance - a bankruptcy or a procedure of liquidation of the enterprise.

The Balance Sheet provides information on the nature and amount of the *investments* within the enterprise, liabilities to creditors and *the founding capital* in the net resources. In this context, we can see the correlation with the Cash flow statement, where the Balance Sheet helps to predict the amounts and the uncertainty of the future cash flows.

As another characteristics of the Balance Sheet, the following could be stated:

- The balance sheet is a **static** overview, which means that it monitors the enterprise at a given moment;
- The balance sheet is a **cumulative** overview, which means that the showed state of the assets and the sources in it is a result of all the activities undertaken in the enterprise since its establishment until the balance sheet date. The implication of this is that there is no way to see the individual changes in individual items from the balance sheet.
- The positions are expressedaccording to their **purchase value**. The values of the items in the balance sheet are presented according to their amount when purchasing the asset or concluding the contract, adjusted for the changes that occurred in the meantime, as a result of depreciation of the assets and repayment of the loans (Brighams & Houston, 2003) .

1. Information benefits from the Balance Sheet

The benefitfrom the information deriving from the Balance Sheet is that it gives the users the basis for calculating the Return on Equity rate (ROE), the rate for calculating of the Return on Assets (ROA), observation and evaluation of the capital structure of the owners as well as assessing the liquidity of the financial flexibility of the enterprise. In addition, we will separately explain every single benefitderiving from the Balance Sheet.

1.1. Calculation of the Return on Equity Rate (ROE – ReturnonEquity)

In order to provide a better perception of the calculation of the returnon equity rate, we present the following formula:

$$\textbf{ROE} = \frac{\textbf{Net profit} \text{ from the current year}}{\text{Average used } \textbf{own capital}}$$

Information from the Balance Sheet

1.2.Calculation of the Return on Assets rate (ROA – Return onAssets)

ROA (Return on Assets) is an indicator of the managerial efficiency that initiates how much has the management managed to use the assets through the information from the Income Statement as an integral part of the financial statements in order to make a profit.

And in this case, we aim to provide better perception of the calculation of this indicator by showing the following formula:

$$\textbf{ROA} = \frac{\textbf{Net profit} \text{ from the current year}}{\text{Total } \textbf{assets}}$$

Information from the Balance Sheet

1.3.Recognizing and evaluating the owners capital structure

The equity capital (stockearning) or you can meet the term *stock capital*, which can be defined as *the remaining deposit, the assets of the enterprise after deducting all of its liabilities*. Here is the structure:

Equity capital

1. ***Stock capital*** **–** the nominal value of the issued stock*(payed capital);*
2. ***Additional payed capital*** **–** payed amount for the issued stocks, which is above their nominal value*(premium);*
3. ***Retained profit*** **–** part of the profits of an enterprise which remained unallocated *(accumulated profit)*.

1.4. Evaluating the liquidity and financial flexibility of the enterprise

With an aim for the enterprise risk to be evaluated and the future cash flows to be assessed, the Balance Sheet is analyzed in terms of financial liquidity and financial stability. The research of Rusevski T. goes in this direction too, in which he defines ***liquidity*** as: "the sum of time that is expected to expire when the asset is sold or converted into cash, or until the liabilitiesare paid", while the ***financial flexibility*** defines it as: "the ability of the enterprise to take effective actions in order to change the amount and timing of the cash flows, thus responding to unexpected needs and opportunities." (Rousseki T., 2001). For instance, the company may become so burdened with debts - financially inflexible - so that its cash resources intended to finance its expansion or planned for repayment of debtsare not sufficient or do not exist at all. An enterprise with a high degree of financial flexibility is more able to survive bad times, recover from unexpectedshocks, and to take the advantage of the profitable and unexpected investment opportunities.

Here I would like to mention the research of Rousseki T. again, where among the other things he states the follows: "... generally speaking, greater financial flexibility means less risk of a company's downfall." (Rousseki T., 2001).

Undoubtedly, when analyzing the Balance Sheet, the liquidity and the financial flexibility must be understood as very important economic principles practiced by the enterprises. But *can the liquidity be achieved, and what is more, to be held turbulent*? The answer to this question would be simple, and it would consist of providing several basic preconditions for providing and maintaining liquidity, such as the following:

1) ifthe long-term sources of assets are bigger than the long-term immobilized assets;

2) if the mobilization of the short-term immobilized assets is faster and bigger in scope from the short – term liabilities which have to be paid;

3) if the enterprise has sufficient amount of reserve liquid assets.

When talking about this, it can be concluded that one of the most important conditions for obtaining liquidity ***constancy*** is in the field of *long-term financing*. That means maintaining the financial balance between the *long-term sources* and the*long-term immobilized assets* in the Balance sheet.

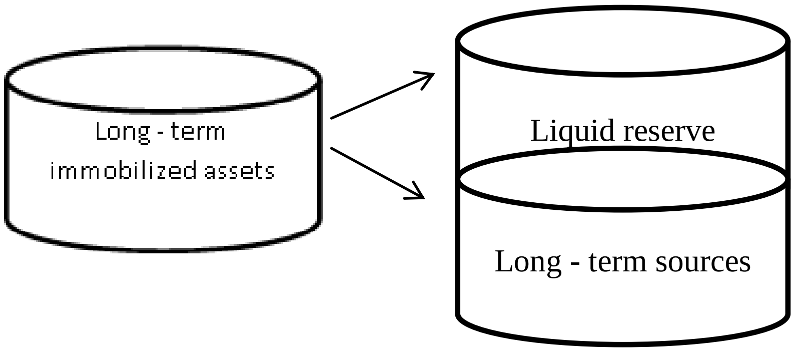
This points to the fact that the liquidity constancy in the enterprises can be maintained by establishing a long-term financial balance, that is, *the real sustainability of the liquidity* will depend on the fact whether the short-term immobilized assets of the enterprise will be converted into money in the specific scope and term when the liabilities on the bases on the short – term sources should be paid.

To simplify the above mentioned, we illustrate this in the following hypothetical Balance Sheet:

Balance sheet 1	
Assets	Liabilities
Immobilized assets 1.000	**Sources of financing 1.000**
- long- term 650	- long – term 650
- short- term 350	- short – term 350

From this reporting of data in the Balance Sheet 1, a state of sustained liquidity can be identified, since the long-term funding sources (650 currency units) are equal to the long-term immobilized assets (650 currency units), which means that the previously set equality requirement between long-term mobilized assets and the long-term sources is satisfied. On one hand, it creates an opportunity for long-term and short-term financial equilibrium, but on the other it does not show that security is provided in the maintaining of the liquidity. The reason is simple, the long-term sources (650 currency units.) are no greater than long-term immobilized assets (650 currency units), which is the failure to meet the first requirement specified above.

In such conditions, we must provide not only basic conditions, but also security in the consistency of the liquidity. This explains the need for a positive difference between long-term sources and long-term immobilized assets i.e. the figures can be shown as follows:



Picture9:*Positive difference that causes a liquid reserve (own illustration)*

In addition to this follows that such a difference is actually a ***liquid reserve***, used to settle the differences that would eventually arise at a given moment between the mobilization of assets on one hand and the volume of default on another.

This, through the hypothetical Balance sheet 2, can be shown on the following way:

Balance sheet 2	
Assets	Liabilities
Immobilized assets 1.000	**Sources of financing 1.000**
- long- term 650	- long – term 700
- short- term 350	- short – term 300

From this example, it can be seen that the conditions for achieving liquidity on one side are provided and the security in the maintenance of liquidity on the other side is also provided. The thing that can be confusing at first glance is that the data for short-term sources (300 currency units), which do not correspond to short-term immobilized aassets (350 currency units.). Therefore, this balance sheet 2 would be simplified by introducing an *example from the practice* where we have a banking institution that has mobilized long-term deposits in the amount of 700 currency units on the side of the liabilities and short-term deposits of 300 currency units. While the information from the assets indicate that the long-term placements in credits amount to 650 currency units, i.e. short-term credit placements of 350 currency units. The conclusion is clear. Although we have placements (immobilized assets) that do not correspond to the bank's deposit collection, it will not become illiquid until the moment when it does not exhaust the liquid reserves of 50 currency units which are derived from the difference between major long-term deposits and long-term credit placements.

Hence, we can conclude the following:**if the liquidity reserves on the basis of long-term financing are higher and the level of security in the maintenance of liquidity will be higher.**

This is just a brief overview,when analyzing the Balance Sheet,how to assess the future cash flows in terms of maintaining a liquidity constant on one hand and reliability in the consistency of another. In the further part of this research, the liquidity indicators will be separately elaborated, and therefore their influence on the management in the enterprise.

2. Faults in the Balance Sheet

Despite the fact that the Balance Sheet with all the positives listed previously is an extraordinarily useful report for the managers, the shareholders, the investors, the creditors, the state authorities, etc., it is still not a perfect display of the enterprise and the potential it possesses at a given moment. Here we have to consider several imperfections of the balance, which do not mean that you should not use it, but they are just a signal for greater caution in its use. Such disadvantages are the following:

- ***the representation of the values of the positions at a purchase (historical) value*** creates a danger as a result of changes in market prices; this value, over the time, drastically distances itself from the market value of the same assets, as well as the shares or bonds issued by the enterprise;
- ***the balances of some accounts are based on estimations***, such as the valuation of claims according to the extent of their chargeability, which again reduces the exactness of the values in it;
- ***the items that can not be valued are not included in the balance sheet***, such as the quality of the management, the staff potential, favorable or unfavorable location, the firm's market position, etc .;
- ***the change in the value of money distorts the image***. Over time, inflation causes deviation and distortion of the values and the relative proportions between the items in the balance sheet.(Arsov , 2008, p. 27.)

Concluding observations

Investigating the problems in terms of the significance and the role of the Balance of the situation in the enterprises, **without any hesitation, I concluded that the information obtained through its analysis, today is an inevitable need and interest for the practical operation and management of the enterprise**, i.e. in other words, in the modern market conditions of the operation and development of business entities in regional, international and, above all, global frameworks, the Balance Sheet, among the other things, enables the management to have an enormous number of data and information for the insight and assessment of the situation in certain moment.

It actually means that even the contemporary trends in the development of the accounting information system for the needs of the management, in general, in addition to the performance of other functions in the operation of the enterprise, point to the performance of the following task:

- to follow the movements - the transformation of the ***assets and the sources of the assets*** at the disposal of the legal and economic entities, quantifying their states successively at a certain time distance and on a certain day. "*critical moment*".

Actually, here we should take into consideration several shortcomings of the balance sheet, in which case it does not mean that we should not use it, but only to give us a signal for greater caution in its use.

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