

## Profit Measurement in Terms of the Financial and Management Accounting

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**Abstract:** *Accounting generally constitutes the most comprehensive economic information system in monetary terms, which is accurately and reliably recorded and provides it to users for decision-making at regular intervals. The deployment of information technology-enabled to reduce the cost of parallel processing of some accounting information for internal management needs as well as for the needs of external reporting. This created space for the application of the so-called dual accounting function distinguishing financial and management accounting as two separate systems. The paper aims to analyse profit in terms of management and financial accounting with the accent to the concept of expenses.*

**Keywords:** *accounting, costs, profit measurement*

*JEL codes: D24, K22, M41*

### 1 Introduction

Accounting is a model representation of reality characterised by the used principles and standards (Fibírová et al., 2011). Tumpach (2008) states that accounting fulfils, among other things, the dual function expressing the principle that the accounting information system contains methodological tools and procedures for processing economic records for external users, i.e., financial accounting as well as for decision-making, i.e., managerial accounting.

Financial accounting is part of corporate accounting (Meng, 2019), providing reliable information about the business management – i.e., about their assets and liabilities, expenses and revenues and economic results (Petřík, 2005; Ling, 2018). It classifies and records financial transactions of a business following principles, accounting standards and legislative requirements, including their presentation in the financial statements during and at the end of the accounting period (Tumpach, 2004).

Management accounting is considered as a subsystem of the entire business accounting system without which accounting could not fulfil its dominant function (Červený and Dvořáková, 2011) within the business information system. It represents a comprehensive concept involving cost accounting, budgeting, and costing (Hradecký et al., 2008). Management accounting provides valuable information about the business management and decision-making information for the business that directly provides an effective information base for the internal management personnel of the business, increasing the efficiency of internal management staff and ensuring the economic benefits of the business (Chen, 2011). Grosu et al. (2019) consider the configuration and complexity of the functional, technical and organisational structure of businesses, together with the diversity of performed activities and the continuous introduction of advanced technologies, as factors promoting management accounting as a fundamental component of the accounting system, while the businesses are restricted to rational use factors for production when consumed resources are minimised, and profits are maximised. Nowadays, many authors consider management accounting part of the sustainable development strategy (Sands et al., 2016; Soderstrom et al., 2017; Zyznarska-Dworczak, 2018).

Comparing management accounting with the financial accounting system highlights a different (dual) concept that, according to Král (2018), is expressed by two main differences. The first difference is that management accounting can be based on differently recognised assets and liabilities as defined, for example, by generally accepted financial accounting principles. The second difference is that management accounting uses greater variability of applied valuation principles and specific valuation methods, based on the

principle that the information about the past can be bad advice for the future and, in accordance with management needs, applies valuation at predetermined (targeted) quantities, at different levels of reproduction cost and the levels of so-called opportunity costs and revenues. According to Ciliková (2008), management accounting mainly provides information for financial accounting, cost information, performance, departments, and other information for decision-making, e.g., evaluating long-term deposits to long-term assets. Several studies deal with the convergence of financial and management accounting, while according to Weißenberger and Angelkort (2011), convergence has led to the increase in the consistency of the financial language. Hemmer and Labro (2008) found that management and financial accounting are not independent, emphasising that financial reporting significantly impacts management accounting (Taipaleenmäki and Ikäheimo, 2013).

One of the most important goals of all business accounting entities is to make a profit (Tasáryová and Pakšiová, 2021). The profit represents a positive economic result, with according to Němec (1998), a higher profit value means that the business has more resources available to contribute to its growth. As amended, the economic result is defined in Section 2(4) of Act no. 431/2002 Coll. on Accounting, as the final assessed effect of the business activities achieved in the accounting period. The economic result is one of the own business resources that in accounting is referred to as equity. Equity represents the part of the own resources of the business financing that is available throughout its existence and the maintenance of which is significant for the assumption of continuing business activity (Pakšiová, Oriskóová, 2020). According to Valaskova et al. (2019), the equity volume decisively determines the business's long-term survival.

## 2 Methodology and Data

The paper aims to analyse businesses' profit in terms of management and financial accounting with the accent to the concept of expenses. From the scientific methods, we use description to define the basic concepts, the comparison to assess the understanding of the economic result, and the cost understanding in terms of financial and management accounting. The information relevant to carrying out the analysis itself we draw from domestic and foreign book publications as well as professional scientific papers.

## 3 Results and Discussion

Among all internal resources, profit has the most significant importance (Ďurišová and Jacková, 2007; Pakšiová, 2017) and is used to measure the financial performance of the business (Pakšiová and Kubaščíková, 2015). The nature of the economic result significantly affects other equity items (Tasáryová and Pakšiová, 2020). According to Lovciová (2018), businesses should try to maximise the value of a business conditioned by making a profit. As the generated profit is the main internal resource of the business, constructive critical analysis of its creation and its quantification to maintain the health of businesses is essential for any decision on its distribution (Pakšiová, 2017).

Information about the results of the business activities is vital for the management of the business itself. While financial accounting obtains this information by comparing the expenses of business with its revenues (i.e., by the financial equivalent of its outputs in the form of produced inventories, non-current assets, energy, and services), a more analytical approach is applied in the management accounting (Tumpach, 2008). The definition of expenses in terms of financial and management accounting is shown in Table 1.

**Table 1** Definition of costs

	<b>Financial accounting</b>	<b>Management accounting</b>
<b>Definition of costs</b>	a decrease in the economic potential during the accounting period, which is reflected as a decrease in the equity of the business that is not the result of its distribution by the owners	a decrease in the economic potential of the business corresponding to regular internal management by the financial equivalent of economic resources spent in connection with a particular purpose and in the case of a strategic focus also the loss of intellectual and social resources resulting from the economic decisions
<b>The time dimension of costs</b>	at the moment when the economic resource "exhausts" its usefulness (e.g., by becoming part of the product sold to the customer)	the cost is already reflected at the moment the economic resource is consumed. However, this expenditure usually does not lead to the overall loss of assets but only to a change in its structure (purchase of materials, machinery).

Source: Tumpach, 2008

The primary form of tracking costs in continental European countries is the breakdown of expenses by nature that answers the question: What economic resources have been consumed? From this point of view, costs are divided according to individual production factors, for example, material cost, wage and personal cost, energy and service consumption, depreciation and amortisation, interest, while the financial accounting will show records of material cost, depreciation, and wage cost without it being clear for what purpose these expenses were incurred.

In the context of the way of expression and valuing the costs, the general basis is considered the triple concept of costs displayed in accounting, namely financial, value (Table 2) and economic (for the purposes of the paper, we will not further deal with the economic concept of expenses).

**Table 2** The basic characteristic of the financial and value concept of costs

<b>Concept of costs</b>	<b>Financial</b>	<b>Value</b>
<b>Relation to the accounting subsystem</b>	financial accounting	cost accounting
<b>Relation to displayed reality</b>	display the transaction in the parameters that applied when it realised	display the transaction in the parameters that would apply at the present
<b>Relation to expenses</b>	there are only time differences between costs and expenses	there are not only time but also material differences, while the subject of the display are also costs that are not accompanied by expenditures in the conventional business cycle
<b>Relation to profit measurement</b>	profit is measured on the principle of financial maintenance of capital in the nominal amount. According to this concept, the business makes a profit, if its own financially expressed capital at the end of the period is higher than at the beginning of the period	profit is measured on the principle of the so-called physical maintenance of capital. According to this concept, the business makes a profit only when it manages to reproduce its own capital measured (and valued) by the capacity of the business activity.

Source: Král, 2018

The financial concept of costs is most applied in financial accounting, while this concept of costs is based on the application of the value cycle form. The value concept of costs was mainly developed in connection with the development of cost accounting, the purpose of which is to provide information for the routine management and control of the real course of currently performed processes. The economic concept of costs is related to the so-called opportunity cost representing the maximum lost revenue that has been sacrificed due to the use of economic resources in a chosen alternative.

As management accounting uses predetermined costs, in this context, the question of how to deal with any differences between the real costs incurred in each centre and their predetermined costs arises. While in the case of centres, resulting in intangible outputs such as research and development centres, general preparation centres and sales centres, these variations are generally automatically included in the economic result. In the case of production centres, two solutions are possible. The first is to include the variations in full to the economic result of the period, no matter whether the related production has been completed and sold or not, which means that even if there were no sales, the variations would be dissolved in the economic result. The second solution is the distribution of variations in proportion to the realised and unrealised outputs, while in this case we also know the resources of the economic result – we know how profitable a particular product is and in which centres have been exceeded or incurred costs and, in the case the finished products were not sold, we would know their valuation not only in predetermined costs but also in real costs. In terms of time, variations between predetermined and real costs can be dissolved continuously, or if certain information is not continuously available, usually retrospectively after the end of the period in which they incurred, which requires the establishment of a perfect operational inventory system, as at the time of settlement of variations, some products may be already sold (Tumpach, 2008).

## Conclusions

The most important feature of a distinct management accounting from the financial is a significantly wider range of information about costs that managers require to manage the business process and decide on future options (King, 2018). The paper aimed to analyse businesses' profit in terms of management and financial accounting with the accent to the concept of costs.

Based on the analysis of costs in terms of financial and management accounting, it can be stated that in financial accounting, records of individual costs are made without it being clear for what purpose these costs were incurred. At the same time, it can be stated that management accounting is based on the value and economic concept of costs. In contrast, the value concept of costs is related to cost accounting, and the economic concept of costs is related to decision-making accounting focused on opportunity costs from which we abstracted for the purposes of the paper. The value concept of costs uses the principle of material conservation of capital when calculating the economic result. In contrast, the financial concept of costs characteristic of financial accounting uses the principle of financial conservation of capital in nominal amount when quantifying economic results.

In settlement of variations between predetermined and real costs, the centre where the variations arise is essential, while in the case of centres with intangible outputs, the variations are dissolved as a result. In the case of centres with tangible outputs, two alternatives are available: the inclusion of variations in full to the economic result or the proportional distribution of variations between realised and unrealised outputs.

## Acknowledgements

The paper was processed as one of the outputs of project I-21-103-00, "Impact of COVID-19 pandemic to evaluate the financial performance of small and medium-sized businesses within the V4 countries from the accounting and tax point of view".

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