FINANCIAL ANALYSIS FROM AN ACCOUNTING POINT OF VIEW*

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Abstract: *Despite the developments which tend to relax the relationship between financial analysis and accounting, property information provided by the latter irreplaceable render its use for diagnostic approaches financial foundation. An efficient information system can provide relevant indicators to users based on accurate and real information and financial analysis results are based on a diagnosis of return and risk.*

The aim of this article is to present primarily the origin and evolution of the relationship between financial analysis and accounting, and the fundamental role which accounting holds, through the information it produces, into analysts' work. The used research method is the bibliographic one, being studied timely books and articles of the domain. Literature does not provide concrete answers to this problem, resolutions being expected especially from practitioners.

Keywords: stock analysis; financial diagnosis; information; performance; normalization.
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INTRODUCTION

Financial analysis is a specialty of finances aimed at formulating a diagnosis and a prognosis relative to the situation and the financial performance of a company or an organization. To achieve its objectives is striving to make an assessment of the level and variability of results and risks affecting the enterprise bankruptcy. Thus, it seeks to measure the value of the entity and its titles.

Given the nature and purpose which it pursues, financial analysis develops the steps of collecting, shaping and treatment of a range of management information which may clarify the wanted diagnosis and prognosis.

Information handled by the financial analysis is given traditionally, by general accounting, which led to the misnomer of "accounting analysis". However, recent evolution led to considerable expansion of information sources handled by the financial analysis, which is profoundly renewed.

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1. OBJECT AND GOALS OF FINANCIAL ANALYSIS

Over the past decades, financial analysis underwent major developments affecting the object depth, its themes and methodological guidelines.

Financial analysis consists, primarily, as a discipline of enterprise-oriented diagnosis. But in exploring this general objective, it has followed a real change of perspective. While traditional orientation led it to focus on studying the financial size of grounding companies, its recent development guides it to consider more than stock characteristics and performance of securities issued by these entities.

Traditional object clearly orients the analysis to study the financial characteristics of firms considered legal and economic entities endowed with effective autonomy. In this perspective, the diagnosis to be made is clearly oriented to the concerns of outside business partners, but directly interested with the survival and development prospects. Taking into account these concerns, leads to a focus on assessing the company's ability to honour commitments it has entered into its business relations and, in particular, those that subscribed to its bankers and others borrowed funds or to suppliers.

This guidance provides a central to solvency study into the analysis. Insofar as it expresses the ability of an economic entity to ensure debts when they occur at maturity, solvency conditions the viability of an enterprise of any independent entity.

Historical profile of financial analysis expresses a predominant point of view of others and a solvency issues. The external financial balance is then the central element of diagnosis. It does not exclude the study of economic performance and financial profitability. But the imperative necessity of enhancing the profitability and capital assigned to the undertaking are not clearly discernible than in market economies where financial investors in general and shareholders in particular, are able to put pressure on companies it finances. In the leverage economies marked by the central role of financing by banks and financial intermediaries, analysing solvency problem remains dominated by the condition reimbursement compliance commitments made to the lenders and not the firm’s survival.

The renewal of missions assigned to financial analysis is inseparable from the important changes affecting the financing regime. This shift calls into question as well the financial structure of firms, i.e. financing circuits on which they are articulated.

Traditional financial analysis approach is deeply consistent with the mechanisms and imperatives of a debt economy. In such an economy, the financing of productive system is essentially based on the establishment of funding and external inputs provided by banks and other financial intermediaries. Consequently, management of credit relationship that is established between businesses and their lenders is one of the major concerns of managers. From the point of view of enterprise compliance period provided for debt service is then a major financial constraint. From the point of view of bankers and other lenders, a priori assessment and monitoring real-time borrowers repayment capacity, assumes a crucial importance. In this perspective, financial analysis acquires the status of a methodological discipline that provides to companies and their borrowers common tools, mainly oriented towards solvency analysis. In conclusion, as far as obtaining a satisfactory economic result makes the future repayment ability, the analytical tradition also interested in analysing operational effectiveness and the intrinsic economic profitability of the company. Given the particular features of French financial system, dominated until the 1980s by a logic of economic leverage, financial analysis French school register, traditionally an analysis perspective external solvency and economic profitability in coherence with nature management profound problems that actors of the productive system and the financial system they had to solve.

Whether the assertion of a financial market economy was recent in France, it has operated long before in the United States and the United-Kingdom and other countries endowed with great tradition stock. Such an orientation of the financial system provides a central financing by issuing shares. It gives, therefore, to shareholders and potential investors a marked influence on the leaders. By expressing their approval of the management of listed companies, the acquisition and retention of securities which it has issued, the stock market actors involved in valuing such securities and consolidate enterprise transmitters and its leaders. Expressing their distrust refusal or title by assignment or by refusing to subscribe to the investors participating in the company's capitalization and depreciation, under certain conditions, bring into question the control and management. Thus, financial market economy allows shareholders to obtain value by force, their remuneration and by imperatives of valuing their contributions. Under these conditions, it requires active management leaders one of their relations with shareholders and pays a close attention to the requirements and enhance market share. Asserting financial market imperatives moving so dominant issue of the financial analysis and constraint inquire more determinants of valuing securities exchange than the problem of debt repayment.

This change of perspective, already old tradition of financial analysis noticeable in the United States or the United Kingdom, not engaged in France until the late 1980s. The gap between national traditions to open the field of financial analysis is only a manifestation of the differences between the characters and the history of the financial systems of those countries. It explains the coexistence in financial analysis “à la française” of a traditional current, always active, oriented economic profitability and solvency analysis and a fast curing currently being oriented to stock analysis.

The renewal of the missions of financial analysis affects the directives that it seeks, and the approaches, methods and nature of the information which it processes. For this purpose, it also tends to change in depth, the traditional relationship between financial analysis and accounting.

2. AN EMPOWERMENT TENDENCY OF FINANCIAL ANALYSIS

Historical relations between the two disciplines, allow for the accounting as an information provider for the financial analysis and the latter as a specialty and value-oriented accounting information exploitation. Undoubtedly, this historical report is always running in the work of financial analysts that the financial information they feed extensively with materials analysis. However, recent developments lead to questioning and increase the complexity of relations between the two disciplines.

Concerning the financial analysis from a historical perspective, the first fields of application of the discipline regard credit analysis and stock analysis. Credit analysis is to assess the risk of creditor banker or bankruptcy for a debtor. In the analysis of stock market, it is growing in relation to investors’ concerns looking to explore their portfolio management, financial markets, assessing risk and return associated with a set of financial assets, shares or other securities issued by various entities in the market. Cost-credit analysis, as well as stock analysis, is therefore oriented to clear operators objectives, dictated by administration issues faced by an actor accurately identified as a creditor or an investor. The initiated efforts are coming, in both cases, from the treatment of a range of management information that can clarify the behaviour of this operator and the two specialties, accounting information is privileged as a source required by the steps of financial analysis.

Through some development, financial analysis tends to be emancipated from its historical relationship with privileged accounts. Relaxation of this relationship essentially depends on four factors.

Firstly, the development of financial markets and various forms of collective management gives high importance to financial analysis application portfolio management. Or, these applications tend to use mainly the statistical data relating to the behaviour of stock market securities that these data refer to performance indicators, such as cost-benefit action, relative indicators of the variability of income gained or series of developments course and transactions observed. It thus appears that information used to open wider on data market than the data accounting records arising from broadcasters' titles.

In its most traditional applications as credit analysis, financial analysis seeks to rely on expectations relating to situation and business results that we study. Or, accounting information by its nature may only provide guidance retrospective. As a consequence, financial analysts orient their economic investments by seeking indications of commercial or industrial, who may soon clarify their effort prediction, but to treat accounting data whose horizon is not a suitable stage.

Finally, numerous sources of information with an extra-accounting character are today proposed by the economic and financial information providers. Although some of these data are originally derived from the accounting documents, given that they will be provided to the analyst, disrupting latter relationship one has with steps and accounting documents. Indeed, many financial databases are in the form of statistical data collection, in which the structure of accounting information is hidden; the organization of these data favours statistical criteria pertinent to the portfolio management methods. Consequently, it tends to fade accounting model underlying the production of monographic data, which is the ultimate source of information relating to companies.

3. METHODOLOGICAL DEVELOPMENTS AND THE EMERGENCE OF NEW RELATIONSHIPS BETWEEN FINANCIAL ANALYSIS AND ACCOUNTING

The increased importance of the portfolio management assumed by financial analysis of the new missions tends to relax its link to the accounting model, if not with the accounting information. But other major developments of financial practice and theoretical and methodological research tend instead to revive, renew and extend this link in new directions.

On the one hand, operator elections and theoretical models related to the financial structure and financing, require an analysis of the structure of liabilities, its evolution, and highlighting the cost of capital. Or, theoretical and practical developments related to funding, require the use of general accounting data. But these are developments of organizational finances, focusing on new concerns, shift objectives and stakes financial analysis steps in a direction that emphasizes information and open up vast prospects stakes links between financial analysis and accounting. Generally, these concerns relate to the links between the financial management of the company and its mode of organization, relations between managers and shareholders, confrontation or adjustment between these different actors strategies, modes of control, of inciting and leading sanctioning relationships among these "actors". Issues of government relations and business brokerage provide a coherent theoretical framework to integrate all these concerns. However, these issues give a major informational dimension of business management. Opening a new field of application for accounting information in financial analysis and valuation, they contribute to strengthening and renewing the historical relationship between the two disciplines. Finally, industrial economic development stress the links among sectorial structure, market structure and business strategy analysis. They relate so important management decisions taken by management in the context of industry and markets in which they must operate. Of course, the industrial economy and analytical approaches of strategic management is widely used in the industrial sector data and commercial technology. But, as shown by the work carried out by plants sectorial nature balance, they can also rely, effectively, given the accounting data expressed in quantitative terms, certain features of technical and economic structures that extend activity and heritage organizations and sectors.

The research with methodological nature also opens new leads that influence the ambivalent line among financial analysis and accounting, as some progress tend to strengthen this link, while others tend to relax instead.

In a first perspective, the research opens up the implementation of statistical methods that allow information on enterprise valuation. This is the case of bankruptcy prediction approaches, called scoring methods. These methods may use extra-accounting information, but in all cases they restructure information blurring reference model uses the default account. To this, it should be noted the ambivalent role played by a number of institutions that have contributed to the creation of databases of financial information and the development of methodologies that allow their valuation. On one side, these institutions, particularly the balance, insurance, credit and financial information providers, contributed largely to the collection of accounting information and the standardization of analytical methods. But otherwise, these bodies have contributed to a statistical approach, which tends to blur the accounting period in which the data that it treats were produced. Also, the statistical approach tends, by its nature, to certify individual characteristics of each unit feeding databases to obtain population profiles of companies that it studied. If it opens wide analytical perspectives, developing statistical treatment of accounting data contributes to a certain relaxation of the link among financial analysis and accounting.

In a second approach, methodological research on the application of artificial intelligence and the development of expert systems oriented towards financial diagnosis, even if the information entered into the accounting system can be known, these approaches tend to fade once more, accounting models, expert systems because the user does not need a detailed overview of the mechanisms that enable the production of all information treated in order to state the diagnosis.

In a third perspective, the financial analysis is developed with reference to the assessment made by experts and operators in the market. It is the meaning of approaches oriented to market consensus, developed in consultation with experts in various offices attached financial analysis that operates on one or more stock exchanges. It is clear that these approaches are based more on the reception and follow-up of expert opinions, as they are based on objective assessments and intuitive than direct treatment of the fundamentals that allowed these experts to make their determination. In matter, the link among market consensus and characteristics of each company, as they expressed general accounts is largely hidden.

General accounting provides financial analysis a source of systematic and homogeneous; in conclusion, it requires a global representation company that proves particularly effective steps to substantiate the diagnosis.

Bookkeeping is a legal obligation for all operators. Specific constraints are, therefore, referred for legal firms with some features that reach a certain size or that affect certain operations. Due to these legal obligations, any company must have the registration and systematic treatment of information concerning its activities and assets. It draws up a material that can serve as support to financial diagnosis.

If accounting information production has a systematic nature it is also clear rules or perceptions of relatively homogeneous. Indeed, the process of normalization has made companies in different parts of the world to keep records on terminology and common rules for presenting documents synthesis in an identical manner. Or, the relative homogeneity of accounting information allows financial analysts to improve readability and, in general, for all its users. From a diagnostic perspective, it first allows applying the same analytical tools for different companies, thus providing a solid foundation of statistical and comparative studies that prove indispensable for formulating a diagnosis, as well as for preparing management decisions based on search for specific external references (benchmarking).

Secondly, homogeneity of approaches always provides some accounting methods and presentations which allow the study of significant financial developments that affect an enterprise over time. Accounting normalization is thus a prerequisite for the development of analysis tools that can have a wide application and to generalize observations regarding the financial behaviour of firms.

General accounting pursues a global representation of an entity. Income statement provides a global view of the expenditure and revenue flows that crossed the undertaking, considered as a whole without internal circulation between components to be highlighted. Also, the balance sheet provides a global situation that entity rights and delegations held firm that she has, that is an overview of the economic situation. Or, such a global representation is particularly suitable point of view of financial diagnosis, because the latter favours the company's financial unit, unit collection, capacity beneficiary and its overall value. Although the analytical guidelines may be useful to clarify certain features of enterprise financial diagnosis tends to propose a synthetic assessment of the situation and accommodate business and therefore the overall representation provided by general accounts.

4. THE LIMITS OF ACCOUNTING INFORMATION AND THE NEED OF EXTRA ACCOUNTING INFORMATION FOR THE FINANCIAL DIAGNOSIS

If financial markets are efficient, all information must be immediately and fully integrated into courses. One of the problems comes from the fact that the produced accounting information is often regarded as late, which is why it is expected from the careful observers of enterprise trends and their environment to anticipate long before official communications. In such a case, the accounting information should be integrated into security prices even before being published. Content information is then nonexistent; communication would not entail any change in the quoted prices, regardless of the degree of market efficiency. Consequently, if there is a significant reaction to the announcement of accounting data rates, information content and informational efficiency of the market, failure to respond may come from the fact that the date does not convey anything new or that the market is not effective.

Due to their nature and concerned objectives, general accounting and financial analysis have deep understanding ways distinct from economic and financial information they need to treat them. Accounting is presented mainly as a system for recording and processing of financial and economic information on the company or any other entity. It is therefore essential to find the right vocation: it adopts a positive approach. Financial analysis develops, in turn, an interpretative approach. It seeks to use the information it deals, in order to make an assessment of the situation or performance of the company (or companies) concerned. It adopts a regulatory approach.

In order that accounting to proceed at records and treatments it must fold to strict rules, or at least the formal principles. It is registered, in conclusion, in a regular framework that, despite the openings listed, is subject to relatively stringent in terms of referral information and presentation documents it produces. Accounting (and only general accounting) is therefore subject to formalism necessary to normalize, even if the reference to the notion of fair picture comes to moderate risk of mechanical application of principles rather than formal regularity.

Financial analysis is widely released instead of formal constraints. In its efforts, it is less concerned than in the rules of relevance assessments priori that it must enunciate. A “good financial analysis” is not only an analysis that proposes a correct calculation for certain indicators or a flawless presentation of pictures and diagrams. It must also identify the most significant financial characteristics of the company, respectively and eventually prioritize in order to achieve a meaningful assessment of the situation, activity and lucid anticipation development prospects. Obviously, the definition of a “good” diagnostic is not an internal criterion of regularity, but one of relevance to the proposed analysis in relation to its object. When drafting and presentation modes of accounting and financial information necessarily requires the use of formal rules, interpretation of accounting information and stating the diagnosis resulting from explanatory and analytical approaches that lend themselves to a hard limit effort or formal normalization.

On the other hand, the diagnosis of enterprise requires consideration of general accounting indicators that it cannot express in a natural context.

Diagnosis calls for the assessment of quality characteristics which in a monetary expression, respectively quantification, prove problematic. Thus, assessing company’s performance and its associated risks, require an assessment of its potential indications based on extensive field overflows accounting information. Assessing by analysts of the technical and trade potential, of the quality or capacity of the management organization, test the appropriateness or quality management system of labour relations, largely escapes a direct understanding of general accounts. In contrast, the latter provides a relevant basis for reporting to global business and wealth. But even on this aspect of diagnosis that seems closest to its own object, general accounting provides only partial guidance.

In conclusion, the importance of quantitative data that must be taken into account in drafting the diagnosis, justify the use of information varied extra-special, even if the accounting framework provides an indispensable reference.

But mostly, diagnosis necessarily involves financial forecasting dimension. If the study of past developments and current situation analysis is an essential moment, the latter mainly aims to make an assessment of expected developments in the near or distant future. Financial analysis thus seeks to assess the sustainable capacity of the company they are studying, i.e. the ability to generate a level term stable performance. It is also looking for appreciation ability of the company to maintain solvency and to face various risks that may affect its future. Diagnosis begins with a necessarily forecast; which carries a dimension of anticipation although accounting information allows only the finding of a situation or operation. In conclusion, it only gives a more contemporary and retrospective information.

Finally, financial analysis maintains with accounting information a necessary, but critical report. Financial diagnosis must be necessarily based on accounting matters. It shall also has to overcome the inherent limitations of this source of information, collecting qualitative or quantitative indication of origin and researching or developing extra-forecast guidance that may clarify further development of the company in terms of performance and risk.

CONCLUSIONS

Developments that affect financial and accounting analysis tend to trivialize the traditional relationship between the two disciplines. While financial analysis has long been confined to a role of implementing and interpreting accounting material, today it also has the role to diversify its sources of information. In essence, it appears more than one specialty diagnostics business by working to identify a true engineering collection, treatment and interpretation of management information relating to companies and their market position. But if financial analyst tends to adopt a position that combines materials assembled from multiple sources to substantiate the diagnosis, his approach cannot fully accounting stalemate on contributions; rather than a loosening of ties between financial analysis and accounting, it is undoubtedly a profound renewal and reinstatement overview of these links.

If accounting information is necessary for financial diagnosis, financial analysis approach however introduces a notable change of perspective; indeed, it remains a gap between optical and financial accounting, despite the progress achieved by accounting normalization openings.

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