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CONFUSION OF ACCOUNTING TERMINOLOGY IN LITHUANIA

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ABSTRACT

This article presents an analysis of issues relevant to the science of finances and the practical side of this field related to financial terms. The article is written with the purpose of helping solve terminology problems of accounting which is viewed as a scientific and practical activity field. The goals of this article are to reveal the current problems of financial terminology in the field of accounting, analyze the reasons of their occurrence, determine the possible and existing negative consequences of the use of incorrect terms in the scientific and practical fields and foresee possible solutions of such problems while aiming to negate or at least reduce its impact. The relevance of the article is that the problem of accounting terms that has been discussed only sporadically is now analyzed entirely starting from its rise and development and encompassing modern times. One of the more significant results of this article is evident proof that the use of incorrect terms has negative impact upon the results provided in financial reports. Also, based on the article, certain conclusions were formed which foresee possible solutions to the analyzed terminology problems occurring in scientific literature and practice.

JEL CLASSIFICATION & KEYWORDS

■ M41 ■ K34 ■ Accounting ■ Terminology ■ Problems in Literature

INTRODUCTION

At present, the field of finance contains several terms the use of which causes confusion and sometimes can be misleading. These terms are related to an important area of a company's operation, which is the description of its accounting. Both the scientists and the people who are faced with it in practice use different terms to define the same matter. This brings much confusion. To begin with, it is related to the use of the terms "financial accounting" and "finance accounting" in scientific literature and in practice.

Contradictory as it may sound, no such term as "financial accounting" is used in the Lithuanian legal acts that regulate accounting administration and submission of financial reports. Instead, the legal acts employ the well-known and easily understandable term "accounting". However, in practice another term, "financial accounting", is widely used and ingrained in the financial jargon, even though it is tailgated by various possible interpretations.

Historical Development

To truly understand the reason of the current situation, it is worth taking a glance at the origin of the term "financial accounting". On June 18, 1992, the Law on the Principles of Accounting of the Republic of Lithuania (as of 2001, the Law on Accounting of the Republic of Lithuania) was adopted. The accrual basis method was set as the new revenue recognition principle in Article 18 by the aforementioned law, and it replaced the cash basis method which had been applied for years before and to which everyone had been accustomed to.

On October 27, 1993, the Government of the Republic of Lithuania approved the Decree on Revenue and Expense Recognition in Accounting. This document laid down a clear and detailed description of the accrual basis method, which was to be applied by companies in their accounting. The aforementioned legal norms became the starting point for the radical accounting reform as well as for the reform of the finance systems of all enterprises, institutions and organizations. In effect, the reform lasted for almost a decade. The reason for such a long time-span was the changes in the paradigm of accounting. The accounting designed to calculate taxes became the accounting designed to provide information about the company.

It was not only the accounting system that had to change during this time, but also the perception of people (both of specialists of accounting and the rest of the society).

However, only at the beginning of the reform the term "financial accounting" was introduced in order to explain the main differences of the new type of accounting to the people who dealt with it in their daily work. This was done with the purpose of emphasizing that the new accounting data was designed not for tax returns as it had been up till then, but for the preparation of financial reports. This term was "borrowed" from the matching English term "financial accounting". In the English language, the aforementioned term defines the accounting, the purpose of which is preparation of financial reports. The first translation of this term into Lithuanian was "finance accounting" (Dauderis, 1993). However, later in practice it gave way to the term "financial accounting" (Kalčinskas & Černius, 1997).

It was inevitable to create a specific term that differed from the earlier used term "bookkeeping". The reason for this was the fact that the new accounting was essentially distinct from the one existing at that particular moment and familiar to both scientists and people who practiced in its field. Its crucial difference which caused many problems of practical application was the employment of a so called accrual principle meaning that revenue was registered when it was earned, irrespective of when the cash was received. It changed the accounting system substantially as the revenue recognition principles in accounting had been significantly altered compared to the previous system. If the previous system involved a relatively simple money principle for revenue recognition (basically, revenue was recognized when the money for the sold goods was received), the new accounting system was identical to the western one and adopted special criteria for sales revenue recognition. Revenue from the sale of goods is to be recognized, registered in accounting and presented in financial statements when the goods have already been sold and the amount of revenue can be measured reliably. The goods are sold when all the following conditions have been satisfied: 1. the selling entity has transferred to the buyer the risks and rewards of ownership of the goods; 2. the entity retains neither continuing managerial involvement nor effective control over the goods sold; 3. it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably; 4. the costs related to the sale transaction can be measured reliably. These issues remain relevant and currently there are harmonized the US GAAP and IFRS (Bohusova & Nerudova, 2009) and talking about accounting quality (Kundelienė 2009, 2010).

Currently these revenue recognition conditions are clearly listed and discussed in Business Accounting Standards (BAS) No. 10: Income. However, in practice during 1992-1993 these criteria were often misinterpreted. To fill the new statement forms accountants preferred using data about revenue recognized according to the old criteria that were no longer valid and, therefore, misleading.

Thus, at that time another term for accounting was required to indicate the preparation of data about the financial status of the company and its activity results based on new criteria and provision of these data in financial statements. This term was to be different from the one already in use ("bookkeeping").

The adjective "financial" was selected due to the fact that the term "finance accounting" could be perceived in a narrower way when bearing in mind the company's finances, i.e. as the accounting of certain assets and cash.

It should also be noted that the concept of the term "finance" tends to change from time to time. In his book Fundamentals of the Finance Science [Lith. Finansų Mokslo Pagrindai], V. Jurgutis notes that "Finance science, especially in the older times, was depicted as the science of state economy and national treasury revenue and expenses" (Jurgutis, 1938). In this case, the concept "finance" is interpreted as the national treasury and the system of collecting, allocating and using these assets.

The Methodological Aspect of the Problem

The concept "finance" is widely used when talking about both company and personal finance. At the company level the term "finance" is used in two ways: as a synonym for "cash" and as the system of earning profit, receiving money and spending it. Therefore, when speaking about companies and using the term "financial management", it usually refers to the company management implemented by using (and limited to) financial ratios (Ponikvar & Tajnikar & Pušnik, 2009). Meanwhile, the term "finance management" is perceived as management of a part of the company's assets, i.e. Cash.

As for the personal finance, the term clearly refers to money, its management and accounting.

Coming back to the concepts of accounting, one can notice that currently both in the scientific jargon and in practical applications several terms are regularly used to describe the same subject, i.e. accounting. These terms are the following: "bookkeeping", "financial accounting" and "finance accounting". If the relation between these terms is not explained properly, it becomes difficult to define the object of practical work as well as that of scientific studies (Mackevičius & Bartaška, 2006; Rudžionienė, 2006).

This problem often occurs in colleges and institutions of higher education, where accounting study programs are provided for studying and several special bachelor study programs exist for Bachelor and Master Degrees in Accounting. At one point in time different terms for the same subject existed in Mykolas Romeris University and they were called "finance accounting" and "bookkeeping". A bachelor degree study program called Bookkeeping and Audit was included in the Management and Business Administration study field in Vilnius University. However, as paradoxical as it may be, in 2009 scientists from the very same university published a book discussing truly important and significant issues of accounting theory and practice, and called *Theory and Practice of Financial Accounting* (Lakis, 2009). Regretfully, this purposeful and meaningful work paid no proper attention to the scientific terms related to correct naming of accounting as a practical field and a field of scientific research. A study program of Accounting exists in the Economic studies in Kaunas University of Technology and a study program Finances and Accounting can be studied in the ISM University of Management and Economics. A conclusion can be drawn that an absence of clear and non-misleading terminology causes issues related to preparation of qualified specialists in institutions of higher education. The reason for this is that even after studying the subjects indicated in the study program the students often fail to understand to which accounting field a particular term is supposed to be applied.

Recently, an endeavor was shown in literature works to solve the aforementioned problem by stating that there are many kinds of accounting in a company's accounting system. To begin with, the following two kinds of accounting can be distinguished in the aforementioned system: financial statements submitted to certain governmental institutions and bookkeeping. Bookkeeping itself can be also divided into recording of financial information and management (cost) information (Kalčinskas, 2010).

The dividing of bookkeeping into two separate kinds (financial and management accounting) reflects the not so recent viewpoint (Долан & Доминенко, 1994). In our opinion, this kind of view can currently be rather misguiding.

In reality, bookkeeping records contain the data required for complete financial statement, profit tax declaration and the preparation of statistical reports. Of course, the main and one of the most important "products" of bookkeeping is financial reports. These reports are generated for the people who are outsiders from the point of view of the company, i.e., company owners, investors and governmental institutions.

This field of accounting is regulated not only by the Lithuanian legal acts, but also by the international laws. To be more precise, it is not accounting itself that is regulated, but rather its "product": external financial reports which are the basis for various persons or institutions to base their decisions on. Naturally, no vague concepts should remain in this field in order not to mislead the users of the information provided in the financial reports.

However, the same bookkeeping data is also used to complete other report forms (tax returns and statistical statements).

Bookkeeping is arranged in such a way that initially the requirements of financial report preparation were satisfied to the maximum. Usually, additional endeavor is needed to prepare other kinds of reports using the bookkeeping data as it needs to be grouped considering different aspects. However, we believe that distinguishing "financial statements submitted to certain governmental institutions" as a separate kind of accounting has no purpose whatsoever as such type of accounting is not managed separately in a company.

Regrettably, recently yet another term is making its way into the practical use, what is "tax accounting" or "accounting for tax purposes" (Kalčinskas, 2001). Some of the authors bluntly say that "A need for two kinds of accounting has appeared. Companies have to separate financial accounting and tax accounting" (Beiga, 2006).

For those who are not acquainted with this system, it might seem (which happens rather often) that the company is managing at least two kinds of accounting (this, however, should not be mistaken and perceived as the illegal "shadow accounting"). One accounting is for the accounting reports and the other one for the preparation of tax returns. This kind of system prevailed in Lithuania up till the accounting reform.

When preparing profit tax declarations, the current system utilizes profit before tax ratio based on bookkeeping data. This ratio is recalculated into taxable profit ratio, on which profit tax is based. No company manages additional accounting with a billing system which calculates taxable profit ratio. The only data stored additionally is that regarding the differences between profit before tax ratio and taxable profit ratio, as it enables the precise calculation of profit tax at a later time.

Other tax returns (e.g., VAT declaration) are prepared based on the data from the bookkeeping accounts with almost no amendments made.

To remain objective, it should be noted that in some cases companies have to calculate the obligation of the deferred profit tax or assets (BAC No.24). All of the taxes that a company has to pay to the government are registered in the bookkeeping accounts as well. This field of accounting could be called "tax accounting". However, it is not a separate accounting system, but rather an accounting of the elements of financial reports that are identical to stock, long-term assets and debts.

Therefore, in our opinion, it is inaccurate to say that a separate tax accounting system exists next to bookkeeping.

As for the internal company management, one has to agree that sometimes the data in the bookkeeping system is not enough to make effective decisions inside the company. Therefore, in this case an additional accounting is needed, and it provides information for "internal use" only. Many terms are used to define this accounting in practice: "management accounting", "managerial accounting", "internal accounting" or "cost accounting" (Lakis, 1998). As we do not wish to debate the name of this kind of accounting, we will only note that such accounting does exist in practice. It's planning and principles are different from the planning and principles of bookkeeping. It should also be noted that this kind of accounting is not regulated by any legal acts and is left to the discretion of the company's management.

Accounting System and the Relation between Different Kinds of Accounting

Yet another truly significant aspect of accounting is that accounting as a practical field is also heavily influenced by the terms used in scientific literature and practice. The goal of accounting is to register data about reporting cycle operations, store them accordingly and prepare for the filling of various reports.

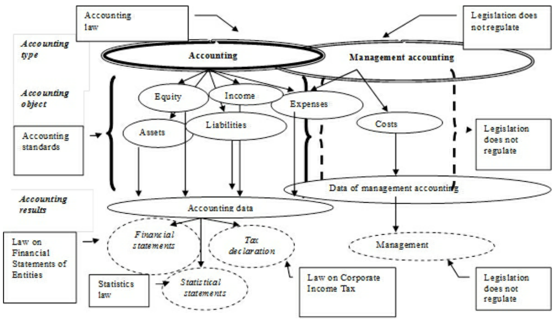
A role of the utmost importance in this field is held by proper practical application of the terms. If accounting is granted the properties of profit tax calculation (influence of the term "tax accounting") due to wrong interpretation of the terms, then the data provided in financial statements, which have very specific and precisely formulated requirements, are fundamentally incorrect (Dagilienė, 2009). This conclusion is confirmed by a research *Application of Business Accounting Standards in Lithuanian Companies* performed by the Finance and Accounting Department of Vilnius University Kaunas Faculty of Humanities (VUKH) in collaboration with the Lithuanian Association of Accountants and Auditors (LAAA). Randomly selected financial reports of companies from the list of largest Lithuanian companies prepared by *Verslo Žinios* were analyzed. Financial reports for the years 2008 and 2007 from a hundred companies were viewed in total. The research results showed that companies did not disclose all of the information required pursuant to the business accounting standards. A conclusion can be drawn that their balance sheets might contain false information as well (Žeimantas, 2010).

This research confirmed the current prevailing trend, according to which a large part of accountants including those of small-scale companies prefer applying tax calculation rules in accounting instead of following the requirements of Business Accounting Standards.

Figure 1 presents the generalized situation related to accounting. As it can be noticed, only one kind of accounting is legally regulated, which is bookkeeping. The management (internal) accounting is mentioned only in Article 8 of the Accounting Law of the Republic of Lithuania. No other kinds of accounting are mentioned in any of the legal acts.

The most strictly regulated results obtained from bookkeeping are the external report forms and their contents. The financial reports are regulated by the Law on Financial Statements of Legal Entities of the Republic of Lithuania; the profit tax declaration is regulated by the laws on calculation and declaration of VAT and other taxes; and the statistical statements are governed by the Law on Statistics of the Republic of Lithuania. However, the companies do not have separate accountings for financial, tax and statistical statements. The quintessence of the work related to accounting administration in companies is that the registration of economic operations is to be managed in such a way that after their first registration only minimum corrections should be required for the preparation of different reports. The simplest, yet the most time-consuming method is management of separate accounts for generation of financial reports, profit tax reports and statistical reports.

Figure 1: Relation between Different Kinds of Accounting



Source: Author

A similar approach prevailed in Lithuania until 2001 when the current edition of the Law on Corporate Income Tax came into effect. According to Article 7 of the aforementioned law when calculating the profit tax, the taxable income and allowable deductions coincide with income and expenses declared in the accounting (Law on Corporate Income Tax) with a few exceptions indicated in the law.

A less sophisticated order has been established in current practice, according to which the required company report forms are prepared on the basis of accounting data, as can be seen in Picture 1. Accounting management itself is regulated not only by the law, but also by a whole set of special legal norms, i.e. Business Accounting Standards

(BAS). What this means is that pursuant to the applicable laws, the accounting approach dominates in the entire information system. All other reports are generated mainly by altering the data from the financial reports in such a way that they meet the necessary requirements.

However, the current arrangement carries additional risk that in the pursuit to avoid mistakes in paying the profit tax and to reduce the workload, the requirements of calculating the profit tax will be applied not only when filling the profit tax report but in accounting management as well. In other words, companies start administering tax accounting instead of accounting. As it was mentioned earlier, this term is firmly taking root in practice. In this case, a serious practical problem arises: financial reports compiled on such basis erroneously reflect the company's financial status and the results of its activities.

Conclusions

A set of conclusions can be drawn from the research of the origins of accounting terminology problems, their influence to science, education and practice when accounting is considered to be both a scientific and practical activity field.

Firstly, the birth of different terms that defined accounting as a scientific field and a field of practical activities was influenced by objective causes. A term that differed from the one used up till then (i.e. bookkeeping) was required because after Lithuania gained its independence the entire finance system had to be reformed pursuant to the new requirements that have been in affect and are still valid in western countries. These changes involved all fields of finance including accounting. The term "financial accounting" was selected to clearly depict the practical function of the new accounting, which is preparation of financial statements. This strengthened the new concept of accounting both in practice and scientific field.

Yet, one must acknowledge that despite a long period of time that has passed from the accounting reform and the start of using new financial jargon, the old term "bookkeeping" remains both in scientific field and practice. It impedes mutual understanding in a scientific field significantly and causes certain confusion in educational field as well for the same subject is called by diverse names in different educational institutions. This field requires regularizing the viewpoints of scientists and making the financial jargon in both scientific field and educational system uniform.

The current confusion is further complicated by the name of the law regulating accounting (i.e. *Accounting Law*) and the two kinds of accounting indicated in the law and prevailing in Lithuania pursuant to the provisions of the same law. These two accountings are called bookkeeping and internal accounting. No other sorts of accounting are indicated by the law whilst in scientific literature a term "financial accounting" has already planted its roots and is perceived among scientists unambiguously with no issues of great importance. Therefore, in this case a reasonable way to uniform the provisions of legal norms and scientific terms is to initiate a correction of terms used in the law for it would significantly reduce misunderstandings caused when science and practice collide with each other.

One of the more important conclusions of this article is the obvious proof that the use of incorrect terms has a negative impact on the results provided in financial reports. It is related to a recently occurred and quickly spreading term "tax accounting". The use of this term seems like an innocent play of words but such a view is gravely misleading. According to research large parts of financial reports are prepared pursuant to profit tax requirements rather than those of Business Accounting Standards. This leads to significant deviations in financial report information. In some cases such deviations might become especially apparent and result in incorrect company reports. Therefore, it is of the utmost importance to assure that the aforementioned term is no longer used in scientific jargon and to prevent its spreading in practice employing any possible means. Otherwise, accountants working in the practical field will have grounds to think that reports prepared pursuant to the provisions of law on profit tax show the true financial status of the company and its operation results.

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