



# Financial Statements in Individual Businesses

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**To cite this article:**

Besnik Hajdari. Financial Statements in Individual Businesses. *American Journal of Operations Management and Information Systems*. Vol. 4, No. 2, 2019, pp. 57-62. doi: 10.11648/j.ajomis.20190402.12

**Received:** March 17, 2019; **Accepted:** June 5, 2019; **Published:** June 19, 2019

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**Abstract:** Understanding and interpreting the financial statements is an important factor for the economic entities in getting the right directions. Today, there is a general tendency to respect the harmonization of European Commission Directive IV with International Financial Reporting Standards. Responsive people need information about the business activities of any business. In this paper, we will consider how to compile and interpret key financial statements in accordance with IASs and IFRSs, which are the main users or users of information derived from these financial statements and their significance in decision-making. Financial Statements are the key elements in achieving business goals, having a bearing on creating business financial reports, auditing, databases and mandatory disclosures. The study aims to identify and analyze key indicators that affect the success and growth of small and medium-sized enterprises (SMEs), ie their performance, and to analyze the effects that these indicators show in SME growth. In this research, several important issues and general problems of the financing system, the financial situation and the profitability of small and medium businesses in Kosovo have been addressed. Also, this paper will present, from the point of view theoretical and empirical, the link between these key performance indicators, or, say, the growth of SMEs. Therefore, the development of the SME sector is very important in Kosovo, especially given that the social problems of those countries are, to a large extent, the consequence of uneven growth.

**Keywords:** Financial Analysis, Financial Statements, Financial Indicators, Financial Reports, Financial Reporting, Accounting Standards, International Accounting Standards, Individual Businesses, Finance

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## 1. Entry

This work, designed and arranged in this way, is the result of a long and irreversible scientific and remedial work in the study and analysis of issues related to the Financial Statements in individual businesses. We will try that the paper in question to satisfy the m given theoretical and practical. We are convinced that the paper represents a modest contribution to the enrichment of economic thought on this religion.

The main motive that has prompted me to deal with this important and current issue is the sense of truth in researching the issue of financial statements into individual businesses, with their main games or forms. Choosing this topic for diploma work, was not done at random, but in consultation, agreement and understanding with my author. So to, one of the main factors that has contributed to dealing with this problem is permanent will and systematic statements, such as the importance, relevance and

multidimensional character of their own.

On the occasion of the conception and the summary of this paper, I have been consulting and consulting classical, current and contemporary sources and literature, starting with texts from the university, economic, social, and political, articles and works and monographs in this field.

## 2. Accounting, Reporting and Auditing

Within this component of our proposed Kosovo Public Expenditure Management model, we will propose three sub-components for which we think will help to improve the functionality of public expenditure management: accounting (accounting), reporting and auditing.

Figure 1 the following presents these three aspects.

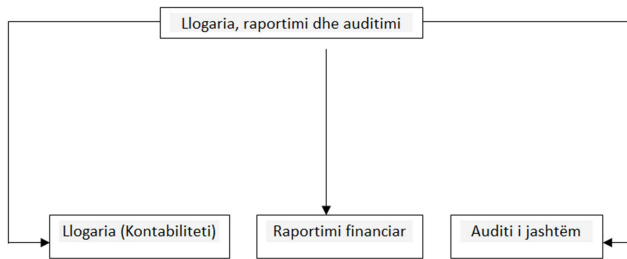


Figure 1. Accounting, reporting and auditing.

## 2.1. Accounting (Accounting)

Within this subcomponent we will propose two key aspects of accounting or accounting of public expenditure management data: Accounting framework (accounting) and reforming the accounting system.

### 2.1.1. Accounting Framework (Accounting)

Accounting and reporting systems are crucial for budget management, financial accountability, and decision-making. Thus, in order to ensure that the use of public funds is in accordance with the rules and laws issued, it is necessary to note the use of budget appropriations at each stage of the spending cycle. For this reason, the basis (moment) of identifying expenditure is created.

The basis for accounting recognition of expenses refers to the accounting principles that determine the moment when the transaction or event should be recognized for financial reporting purposes.

There is a spectrum of accounting bases, which can be listed from the cash account on one side to full accrual accounting. Between are some variants of cash change or accrual accounting.

### 2.1.2. Accounting in Cash

"The cash basis of accounting measures the flow of cash resources. This form of accounting recognizes the transaction only when cash is received or paid." Financial statements under this type of accounting cover cash receipts, cash outflow, and cash opening and closing. The financial reporting system under this accounting basis has several advantages because it is simple and comparable to monetary data.

### 2.1.3. Accounting (Account) Flow

"Full-flow accounting recognizes transactions when they occur, no matter when cash is paid or accepted. Revenues reflect the amount that decreases during the year, regardless of whether it is collected or not. Expenditures reflect the amount of goods and services consumed during the year, regardless of whether or not they were paid in that period. Asset prices are known when assets are used to provide services".

Financial statements under this type of accounting cover revenues, costs (including amortization), assets (financial and physical, current and capital), liabilities, and other economic flows.

In Kosovo there is an accrual accounting system, which

has proved to be very successful. This includes the flow of revenues, expenses, assets, no matter when they are realized or paid. The payment system is on a cash basis with the exception of long-term capital projects for which commitments can be transferred in subsequent years.

### 2.1.4. Reforming the Accounting System

For the purpose of reforming the accounting system, certain activities should be undertaken in order to ascertain the current weaknesses of the existing system, such as whether they are safely and completely monitored the obligations that may be increased during the execution of the budget, is the payment reporting done in a transparent manner, are the accounting procedures clearly defined, etc.?

Regardless of which is the accounting basis (cash, modified or accrual), an accounting system should have the following features:

1. Effective procedures for keeping accounting books, effective records of transactions, high level of data security and systematic comparison with bank statements. Computerization of data helps to improve accounting procedures.
2. All transactions (including internal and external loans) in relation to revenues and expenditures should be recorded in separate accounts according to a unique methodology.
3. An adequate approach to the classification of expenditures by economic and functional categories.
4. Clearly documented and clearly defined accounting procedures.
5. Regular issuance of financial reports and financial statements.
6. Building an adequate system for using appropriations (budget accounting) at each stage of the spending cycle (commitment, verification, and payment).
7. Transparent reporting of transactions.
8. Correct interpretation of information etc.

The priority areas for improvement of the accounting system in Kosovo are:

1. Implement a comprehensive budget accounting system for the efficient use of budget appropriations at each stage of the spending cycle. This system should include appropriations, commitments / obligations, verification of expenses and payments.
2. Establishment of an accounting system for debts, financial liabilities and contingent liabilities in accordance with accrual accounting principles.

## 2.2. Financial Reporting

Within this sub-component for our public expenditure management model we will present two aspects: general objectives and financial reporting principles and the most important reporting games.

### 2.2.1. General Objectives and Principles of Financial Reporting

The essential purpose of financial reporting is to clearly

reflect the data on which the Government has managed the financial resources, revenues and expenditures, assets and liabilities. It would be very helpful if we positively assessed the overall financial reporting objectives and which can be summarized in the form of the following questions:

1. *Budget integrity.* Have the resources been used in accordance with legal authorizations and submitted requests? What is the share of unmatched appropriations? How much are the committed, but not paid, expenses etc?
2. *Operational performance.* How much are the programs cost? How are they funded? What has been achieved? How has the government managed its assets?
3. *Systems and control.* Can systems ensure full compliance with financial and budgetary regulations?

Reports represent an important instrument for policy planning and formulation. They should therefore contain information on the following programs and the main objectives of the spending agencies and which can be used in Parliament and the general public.

Financial reporting should be based on some basic principles of reports prepared by the Government for internal and external use such as:

1. The *principle of the complete report.* The information in general should cover all aspects of the Government's financial reports.
2. *Legitimacy.* The form and content of financial reports should be acceptable to their users and in accordance with financial reporting standards.
3. *Clarity of financial reports.* The information provided in the financial report should be easily understood by their users.
4. *Reliability.* The information in the financial report must be reliable.
5. *Relevance.* The information in the report is provided to meet an explicit need. Financial reports should take into account the different needs of different users.
6. *Consistency.* It is required that the reports are consistent with the similarity of reflection methodology.
7. *Deadline.* Reports should be prepared on time and according to the foreseen procedures
8. *Comparability.* Financial reports should provide comparative approaches between similar reporting units.

### 2.2.2. Financial Accounting Reports

Many reports are used in the financial reports, and we will propose some of the most relevant to our model and also used in the financial reporting practice of many transition countries.

1. *Execution reports of the budget* include short daily reports and cash flow, monthly budget execution reports based on the budget classification system.

*Financial reports*, include:

- a) *minimum financial reporting requirements* (report on the consolidated financial operations of different government levels, summary report on the execution

of the government spending program, the external debt ratio in the medium term, the short-term borrowing ratio, the grant report, the report on lending, my next statement, the statement on the cash flow statement, statement of tax expense, other obligations, etc.).

- b) *Financial Statements Accrual Accounting System.* According to GFS 2000, the following key statements should be prepared in this case: summary of government financial transactions for a reporting period, statement of other economic flows, balance sheet, resource statement and cash use.
  - c) *Coverage of financial reports within the Government.* Financial reports should cover all government entities.
  - d) *Non-governmental public entities.* Public non-governmental entities or those owned by the Government should produce financial reports.
2. *Line ministry reports* include ministry policies, goals and objectives, programs, projects, fiscal and financial performance, cost estimates, performance indicators, and other information.
  3. *Reports on capital investment* expenditures (current spending in the verification phase during the current year and last year, etc.).

### 2.3. External Audit

Within this sub-component we will present these aspects of the external audit: the prerequisites for an effective audit, the types of audit, the reporting of audit results and the actions on audit results.

#### 2.3.1. Par Vigor for an Effective Audit

The audit, together with internal control and evaluation, comprises the processes and mechanisms that should ensure that planning, budgeting and utilizing public resources is made in accordance with the applicable legislation. Without these mechanisms, there is considerable risk that decisions are not taken on the basis of adequate estimates of financial resources management. Public sector auditing is also very important in order for taxpayers to make sure that the spending of public revenues is under control.

There is a big difference between the so-called internal and external auditing. This mainly relates to the level of independence of auditors. Auditors should be fully independent of the audit agency and by the agency to report on the audit results.

Guidelines for audit processes are also provided in the Lima Declaration published at the International Organization of Supreme Audit Institutions (INTOSAI), which requires the establishment of an audit as a mechanism for controlling public fund management in all countries.

With the document of the SAI Presidents of Central and Eastern European countries and the European Court of Auditors of 1999, some recommendations are given that will help the SAI to play its major role in the audit field. These recommendations are also compatible with the need to build

an effective audit in Kosovo and relate to the following:

1. The Supreme Audit Institution (ISA) should have a solid legal basis based on constitution and law.
2. The Supreme Audit Institution must have functional, organizational, operational and financial independence.
3. The institution... must have legal and constitutional power to audit all public resources and financial activities.
4. Institution should include all external audits of the Government, covering the regularity and performance of audits.
5. The institution... should be able to report freely and without restriction on the results of its work etc.

**2.3.2. Types of Audit**

For our public expenditure management model in the external auditing process we would propose these types of audit:

- a) Ex ante audit. It is about examining individual transactions before they are completed if they have legal regularity.
- b) Ex post audit. It is about examinations after the transactions have taken place.
- c) The following audit. It is about controlling individual transactions as they happen to make sure that the necessary appropriations are made and available with relevant documents.
- d) Performance auditing. It is about examining an internal entity, its activities and programs, in order to suggest ways to improve the efficiency of the activities.

**2.4. Reporting Audit Results**

Audit results should be reported to Parliament on an annual basis.

**2.5. Actions on Audit Outcomes**

Upon completion of the audit, its reporting to the Parliament and the recommendations made by the audit, the audited agencies must meet the recommendations given by the external auditor at the time and in the manner prescribed by law.

**2.6. Model: Case Study**

In the following, we will measure the elasticity of GDP in relation to the various categories of government spending using econometric methods. The model follows the approach proposed by Fan and Rao (2003), who have measured a log-log logic function, where country GDP is a dependent variable while different government spending categories as independent variables. In our concrete case, we have

constructed a model as it is specified below:

- Where: GDP is real GDP in year t,  
 PM - Government spending as wages and salaries in year t,  
 MoH - government spending as goods and services in year t,  
 S - Government spending as subsidies and transfers in year t,  
 SHK - government expenditures as capital expenditures in year t,  
 PDHR - government spending as payments and reserves in year t.

We expect a priori that all categories of expenditures have a positive impact on the growth of GDP, is understood to varying degrees. We also a priori expect that the exception will be spending incurred for subsidies and transfers, as these funds are mainly allocated to public enterprises that generate economic losses.

As noted above, we in this model apply the double logarithmic specification. One of the attractive characteristics of double logarithmic (log-log) models that have become very widespread in the applicable analysis is that the coefficients measure elasticity. In other words, since double logarithmic forms have been used, the coefficients measured will be elasticity of the dependent variable (GDP) in relation to independent variables (wages and salaries, goods and services, subsidies and transfers, capital expenditures, payment and reservation). Thus, the results represent the percentage change in GDP as a result of the percentage change in the various components of budget expenditures.

**2.7. Data**

The data used for this model were obtained from KCB Financial Statements 2000-2007, Treasury Department - Ministry of Economy and Finance (presented in Table 2 - Volume, type and structure of public expenditure (budget)). However, the number of observations is small, given that it is an annual report, and there is no quarterly data. This consequently limits our analysis, however, the model may draw some orientation data. The data has been transformed into natural logs and tabled in addition to the number 2.

**3. Results**

*Table 1. Regression Results (OLS).*

variable	coefficients	Standard deviation
PM	0. 5067133	0. 6848658
MH	0. 0140319	0. 5039267
S	-0. 2423857	0. 6537995
SHK	0. 1423699	0. 8137629
PDHR	0. 0102744	0. 138202
CON	2. 434182	0. 796048

*Table 2. Data in logarithmic form.*

GDP	PM	MH	S	SHK	PDHR
3. 177248	1. 792532	1. 791129	1. 634578	1. 499467	0
3. 345766	2. 029879	1. 953905	1. 44331	1. 524578	0. 837588
3. 35141	2. 086217	2. 084254	1. 926908	1. 792602	0
3. 351989	2. 16346	2. 244277	2. 113776	1. 96895	0. 371068

GDP	PM	MH	S	SHK	PDHR
3. 358316	2. 265784	2. 274873	2. 267641	2. 272862	0. 597695
3. 344196	2. 289143	2. 154971	2. 330109	2. 161008	0
3. 352183	2. 315928	2. 128173	19863	2. 141073	1. 264227
3. 531479	2. 31998	2. 12346	2. 189069	2. 20197	1. 252974

The data were analyzed using the econometric method of regression. Regression analyzes the relationship between the dependent variable and one or more independent variables. We have applied the OLS (Ordinary Least Squares) method and the obtained results are presented in Table 1 (for results obtained from STATA software see Table 3. The results, as such, are not significant, mainly because of the small number of surveys, however present some important orientation details. The coefficients of the independent variables are consistent with our theoretical expectations, which means that expenditures in each budget category have a positive impact on GDP growth (some with greater impact and fewer ones, for example, spending in wages and salaries and capital expenditures have the highest impact on economic growth while expenditures on other payments and reserves have the lowest impact), besides the budget expenditures on subsidies and transfers which a priori a priori have had a negative impact given that in Kosovo is mainly subsidized by public enterprises that generate economic losses (for example, the Kosovo Energy Corporation (KEK), and as such do not have

a positive impact on GDP growth. However, even though the results have a proper mark, yet again, the reader should carefully interpret these results given that the results are not signify but the results are orientates and show the direction of the relationship between GDP and various categories of government expenditures.

#### 4. Application Pattern Dynamics

In terms of time, the model has a one-year application length but the model results are repeatable and applicable for a much longer period than a year. The application of the quantitative components of the proposed model will increase the efficiency of public expenditure management and budget processes in Kosovo. Meanwhile, the quality component of the model follows the role and impact of some independent variables in economic growth, according to which the Government must correct its actions. The modular presentation of the application dynamics of the model will be as in the following table:

Table 3. Application Pattern Dynamics.

The quantitative and qualitative aspect of the model	J	SH	M	P	M	Q	K	G	SH	T	N	DEC
I) The quantitative aspect of the model												
A) The budget and the institution context.												
- budget fulfilment	x	x	x	x	x	x	x	x	x	x	x	x
- budget documents	x	x	x	x	x	x	x	x	x	x	x	x
- legal and institutional framework	x	x	x	x	x	x	x	x	x	x	x	x
B) Allocation of resources												
- budget classification									x	x	x	x
- Presentation of the expense. in the budget										x		
- program approach				x	x	x						
- macroeconomic framework				x	x							
C) Budget Execution Management												
- the budget execution cycle	x	x	x	x	x	x	x	x	x	x	x	x
- internal control and internal audit						x						
D) Accounting, auditing and reporting												
- Accounting												
- financial reports	x	x	x		x	x	x	x	x		x	x
- auditing				x	x	x	x		x	x		x
II) The qualitative aspect of the model												
- assessment of public expenditure management and budget processes	x	x	x	x	x	x	x	x	x		x	x
- the impact of public expenditure management on economic growth			x	x	x					x		

## 5. Conclusions

Based on the findings that emerge from the analysis of the public spending performance in the Republic of Kosovo and which are presented in this doctoral thesis in the four, five and sixth parts of the paper, as well as the findings that emerge from the econometric model working on the seventh part of the paper, we will make some recommendations, which we consider to help further improve the management of public spending and their impact on the country's economic growth.

### 5.1. Fiscal Policy should be built on the Basis of the Empowerment of at Least Two of the Most Important Components

a) *Maintaining and enhancing fiscal discipline and budgetary sustainability in country.* Raising efficiency in collecting fiscal revenues and combating the phenomenon of fiscal evasion in Kosovo is one of the main components of fiscal discipline. At the same time, evident improvements in this area would have an impact on increasing budget sustainability and improving fiscal parameters, on the one

hand, and greater public investment opportunities, on the other hand, affecting economic growth. *The best fiscal policy would be in cases where the tax burden on taxpayers is small, the wider scope of tax burden and low tax rates.*

b) Fiscal policy should be in function of Kosovo's economic development.

Fiscal policy in Kosovo should be competitive not only in the region but also beyond. This will have a positive impact especially on attracting foreign investment, improving the economic structure in Kosovo, increasing exports and improving trade balance, increasing consumption, investments and ultimately increasing economic growth.

### **5.2. The Legal Infrastructure in the Field of Building Budgetary and Fiscal Policies Should be Flexible and Integrative**

In Kosovo, in the post-war period, an applicable budget and fiscal infrastructure was issued. It needs to be reformed depending on the demands of the market economy and economic integration (especially the fiscal one) and be flexible enough. Likewise, the Law on Public Financial Management and Accountability should support the processes of effective, transparent and accountable use of budget funds. The Law on Reformed Public Procurement (and as often amended), especially in the section dealing with the type of contracts according to procurement procedures, should provide for the mechanism of application of *open procedures procurement* in awarding contracts. This will enable the highest value of contracts to provide greater participation of accountable bidders, greater transparency and budget rationalization.

### **5.3. Budget Planning Should Be Well Prepared and Timely**

Timely and accurate planning of budget revenues also enables budget expenditures to be planned with greater precision. Planning budget expenditures should go down to the level of detail planning of the programs and within them also project planning. *Accuracy in the volume of planning of the necessary budget funds for each of the projects enables a great rationalization of the means, the realization of a greater number of investment projects and consequently the greater economic growth.* The Medium Term Expenditure

Framework (MTEF), which is currently drafted annually by the Ministry of Finance and Economy, should be more accurate in evaluating spending agencies' investment projects and updated annually.

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