ANALYSIS OF THE DYNAMIC FINANCIAL BALANCE

CIPRIAN APOSTOL
FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION
"ALEXANDRU IOAN CUZA" UNIVERSITY OF IAŞI, BD. CAROL I, NR. 22, 700505,
ciprian.apostol@uaic.ro

Abstract:
This analysis is an important step in examining the documents summarizing the financial situation of organizations. In the context where the mere comparison of balance sheets and income statements, even over a period of several fiscal years, can only explain the net result of the movements in the opposite direction, of the type, acquisition, and ceding of fixed assets or loans and debt collection, the approach of the financial analysis using the flow method was required, starting from the concept of flow fund, which allows determining the cash surplus generated by the activity of the organization, such as the operational cash surplus.
The cash flow statement provides information on the degree to which the various activities of the company generate cash surplus or deficits.

Key words: *cash flows, cash flow statement, cash*

JEL classification: *M49*

The notion of ***flow*** indicates a movement or transfer of a quantity of goods or currency over a period of time (Siminică M., 2008). An accounting operation can be considered a flow when it has an impact over cash. In this sense, the "concept of flow can be defined as referring to all the movements generated by the economic operations performed by the organization, which will have an impact, immediately or subsequently, over cash" (Siminică M., 2008).

In this article, we have aimed at analyzing the dynamic financial balance of a pharmaceutical organization, using data from its *Cash Flow Statement*. In this sense, following the study of specialized literature, we have reviewed a series of theoretical aspects regarding the method of determining the dynamic financial balance of an organization, ending with a practical example.

Following the great diversity of the flows within an organization, their analysis requires their classification according to several criteria, such as (Buşe L., 2005):

- ***According to their contents***, flows may be:
  - *Real (fund) flows*, which presuppose incoming and outgoing goods and services, through economic transactions;
  - *Financial flows*, which include movements with influences on cash, immediately or after a certain delay.
- ***According to their moment of incidence on cash***, flows may be:
  - *Cash flows*, representing the difference between the incomes and payments for the respective period;
  - *Shifted flows*, which initially take the form of account receivables and debts, and later influence cash.
- ***According to their destination***, flows may be:
  - *Financial usage flows*, representing the cash used to purchase fixed assets, stocks, or to increase the accounts receivable from the customers;
  - *Resource financial flows*, which imply a cash increase through various methods, such as: a diminution of the accounts receivable from the customers, shareholders inputs, contracting credits, etc.

➢ ***According to the activities that generate them***, flows may be:
- *Operational flows*, which are the result of the current activity of the organization;
- *Investment flows*, generated by purchasing or selling fixed assets;
- *Financing flows*, which are the result of the operations between the organization and the capital owners (shareholders and crediting institutions).

According to OMFP no. 1752/2005 modified by OMEF no. 2374/2007, the *Cash Flow Statement* has been included in the annual financial statements, allowing for a dynamic analysis of the financial balance, through a description of the operations according to activity types, which have triggered a transformation of the property.

In IAS 7 *Cash Flow Statements*, cash flows are presented as *incoming or outgoing cash and cash equivalents, during a fiscal year. Cash includes available money and deposits. Cash equivalents are short-term financial investments, highly liquid, which are easily convertible in known amounts of cash and subject to an insignificant risk of changing their value*.

The cash flow statement provides information regarding the degree to which the various activities of the organization generate cash surplus or deficits. Cash flows are divided into three categories, namely: operational cash flows, investment cash flows, and financing cash flows.

Cash flows can be computed using the direct or indirect method.

The direct method consists in subtracting the payments from the cash-ins corresponding to the fiscal year, according to activity types. Based on this method, future cash flows are estimated as totals and per activity.

The indirect method is simpler to apply and presupposes computing the operational cash flows using the information from accrual accounting. Therefore, cash flows are determined by correcting the net result with the influences of non-monetary operations, as well as with the variation of the necessary net circulating assets. If the net cash for the other activities is added to these flows, there results the total net cash, at the beginning and at the end of the period, and the difference obtained represents the variation of the cash flow (Petrescu S., 2008), which can also be computed as the difference between cash and cash equivalents at the end (TN_1) and at the beginning of the fiscal year (TN_0).

$$\Delta TN = \text{operational } \Delta TN + \text{investment } \Delta TN + \text{financing } \Delta TN$$
$$\Delta TN = TN_1 - TN_0$$

The financial analysis of an organization through the study of the cash flows implies certain difficulties generated by aspects regarding (Bătrâncea I., 2008):
- *The elements considered as cash or cash equivalents*: although cash equivalents are defined in a relatively similar manner, the investment policy in current or fixed assets is set by the organization. For instance, an organization that performs financial intermediation operations may decide for all its investments to be classified as cash equivalents, while an organization whose operations consist in short-term, inactive, highly liquid financial investments as shares may decide to classify these assets as investments;
- *The options for including certain cash flows into one of the three categories of activities*: for example, the interest corresponding to contracted credits is included in operational activities, while contracted or returned credits are included in financing activities;
- *The preference for the direct or for the indirect method for determining operational cash flows.*

On the other hand, the analysis and interpretation of the cash flow statement concerns the following procedures and objectives (Achim M. V., 2009):

- Establishing the activities that have generated a cash surplus or deficit and explaining the causes for this generation;
- Examining the cash flows from the current operations in order to establish if they are positive and to determine the difference between the operational result and the net operational flows;
- Comparing the cash flows from the current operations with dividend payments from financing activities, in order to determine if this outgoing cash is covered and does not represent a special effort for the company;
- Examining the investment activity in order to draw the conclusion of whether or not the company extends its activity and the parts involved in the expansion or restraint;
- Following the analysis of the investment activity, financing is examined in order to observe the manner in which the organization finances its development or, if it does not expand, the manner in which it reduces its financing debts.

The indicators that stress the cash flows in absolute values are determined in the cash flow statements. In the case of the analyzed organization, the cash flow statement is drawn according to the direct method. The table below presents the main cash flow categories:

Table 1

Cash flow statement analysis

Indic. (lei)	Years						
	2002	2003	2004	2005	2006	2007	2008
ΔTNE	4555259	8035450	3012026	14448194	-1693784	12642100	13719189
ΔTNI	-7344507	-6426783	-7221410	-15773452	-8780584	-11206008	-6744268
ΔTNF	2883440	3025028	-1423748	5897104	7393220	-1940723	713006
ΔTN	-61385	4451218	-3533937	4245909	-2775105	-504632	7687939

Note:
ΔTNE – Net operational cash flow
ΔTNI – Net investment cash flow
ΔTNF – Net financing cash flow
ΔTN – Total net cash flow

Interpretation:

The analysis of the table data leads us to the following conclusions:

- During the analyzed period, we notice that the organization has experienced both cash surplus and deficits. Therefore, for the first four years, we can notice an alternation of cash deficit and cash surplus (from –61,385 lei in 2002 to 4,451,218 lei in 2003, then from –3,533,937 lei in 2004 to 4,245,909 lei in 2005). In 2006, the organization experiences again a cash deficit (-2,775,105 lei) that it partially compensates in 2007 (-504,632 lei), and in 2008, after contracting bank credits, it experiences a cash surplus of 7,687,939 lei;
- Operational cash flow is positive, except for 2006 (-1,693,784 lei) and has an important contribution to achieving net cash flows. The evolution of these cash flows has been primarily determined by the large volume of income following the sales of goods and provision of service (which contribute to flow increases) and by the payments made by providers and in the name of the employees (which lead to decreasing flows);
- For the entire analyzed period, investment cash flows have had negative values, having a negative impact on the net cash flows. These flows represent a cash

deficit, caused by the annual investments in fixed assets, and payments exceed this type of incomes;

- Financing cash flows have positive values, except for 2004 (-1,423,748 lei) and 2007 (-1,940,723 lei), which is the result of the company's contracting credits, mainly on the short term (which lead to flow increases) and of payments related to leasing operations and dividends (which determine a decrease of the cash flows).

The evolution of the cash flows can also be visualized in the graphic below:

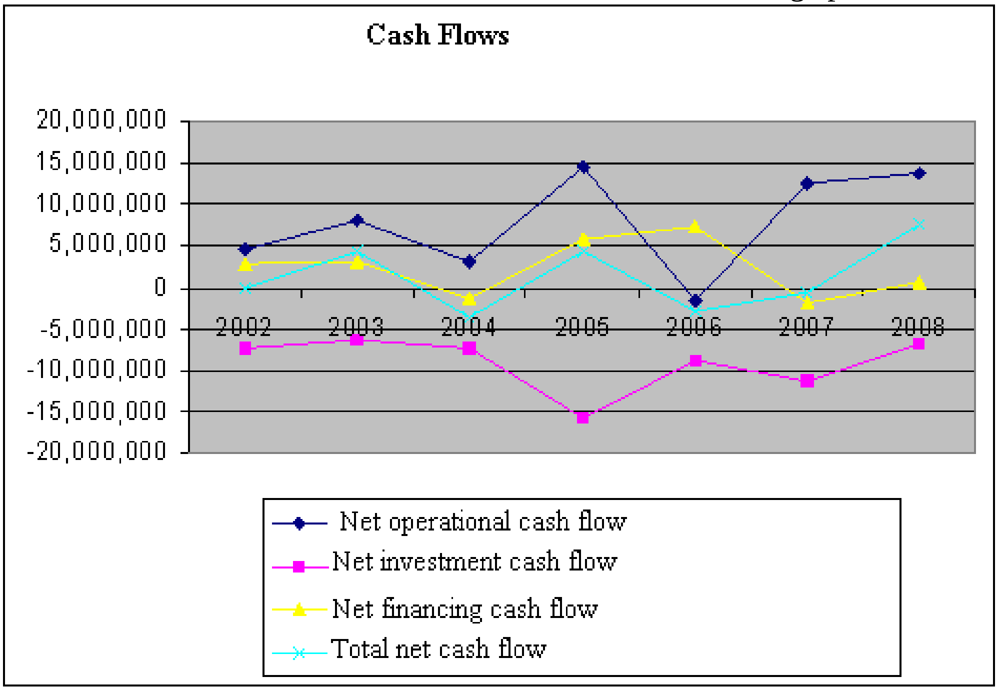

Fig. 1 – Cash flows evolution

The cash flow statement indicates the source of provenience of liquidities, as well as the manner in which they have been spent, thus explaining the causes of their variation. The information presented should allow the users to evaluate the ability of the organization to pay dividends or honor other engagements. Moreover, this information allows noticing the possible variations between the net result and operational cash flows. In conclusion, the cash flow statement facilitates the analysis of the financial dynamics of organizations.

REFERENCES

1. Achim M. V., 2009 – *Analiză economico-financiară*. Risoprint Publishing House, Cluj-Napoca;
2. Bătrâncea I., 2008 – *Analiza trezoreriei entităţii economice. Modelare, echilibru, eficienţă, previziune*. Risoprint Publishing House, Cluj-Napoca;
3. Buşe L., 2005 – *Analiză economico-financiară*. Editura Economică, Bucharest;
4. Petrescu S., 2008 - *Analiză şi diagnostic financiar-contabil. Ghid teoretico-aplicativ*. Second edition, revised and completed, CECCAR Publishing House, Bucharest;
5. Siminică M., 2008 - *Diagnosticul financiar al firmei*, Universitaria Publishing House, Craiova;
6. ***, 2006 - *Standardele Internaţionale de Raportare Financiară 2006,* CECCAR Publishing House, Bucharest*;*