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CONSIDERATIONS RELATED TO THE ANALYSIS OF THE FINANCIAL BALANCE OF THE TRADING COMPANY INTERLINK GROUP SRL

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Abstract: *The analysis of the financial balance in the company's activity implies the amortization of the resources with the needs, reflected as the functional balance sheet. The information transmitted by means of the accounting balance sheet as a synthesis document, is processed and grouped so that the view on the company appears from the functional point of view and the functional presentation of the balance sheet highlights financial, structural aspects that best respond to the requirements of the company managers. According to the functional point of view, the company is the economic entity whose essential objective is the production of goods and services, its activity implying the exertion of the production, trade, investments and financing functions. The paper aims at establishing a financial diagnosis allowing the appreciation of the conditions in which financial balance is made for the continuity of INTERLINK GROUP SRL company's activity and attaining the proposed intend.*

Key words: *accounting balance sheet, functional balance sheet, working capital, working capital needs, treasury.*

1. Introduction

The reflection of the company INTERLINK GROUP SRL financial balance is made through the financial analysis of the financial balance sheet. The balance sheet is the main instrument supplying information related to the company's activity. It reflects the financial position of the company at a certain time, generally at the end of the tax year [4] and it expresses, in monetary units, the value of the economic goods correlated with their financing sources, as well as with the obtained result.

The information related to the assets, liabilities and equities reflected within the balance sheet may be processed and presented for the financial analysis in the form of: 1) - Financial balance sheet or the "liquidity" balance sheet and
2) - Functional balance sheet.

The functional balance sheet is the form that allows ***the study of the financial balance*** by means of three analysis variants: ***horizontal analysis*** *(working capital, working capital needs, treasury)*, ***vertical analysis*** (by means of the structure ratios – *financial independence, the indebtness degree, the global indebtness degree*) and ***the analysis by combined ratios*** *(the ratios of solvency and liquidity and the ratios of the rotation of the component elements of the working capital needs*) [2]. The functional balance sheet

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presents the assets and liabilities elements of the company, at their gross value (their initial value), structured according to the description of the cycles of the companies' life, compared to its development, in the investment cycle (purchase, creation and selling of the fixed assets elements), in the exploitation cycle (development of the exploitation activity) and in the financing cycle (establishing the financial resources required for the company's development). To carry out the activity object for which it was established, the company deploys several economic functions: manufacture, trade, treasury, investments and financing.

First of all, the functional analysis includes the exploitation cycle that includes the following steps: raw materials supply and storage, manufacture, storage of the finite products, marketing and casing up from the sales. The assets positions (stocks, outstanding debts, clients, accrued expenses) strongly connected to the operations of the exploitation cycle, represent **the exploitation current assets,** that, in the normal activity must be financed from **the exploitation debts** (suppliers' and financial debts, prepaid incomes from exploitation). Both the current assets and the resources for their financing are cyclic.

The other positions of the balance sheet are regrouped in **current assets outside exploitation** and **debts outside exploitation,** and those related to the disposable funds are grouped in the **treasury assets** and **liabilities.** The investment and financing function completes the financial analysis by drafting the *financing chart* [6].

The functional balance sheet allows the determination of the ***global net working capital*** and ***the working capital needs***, on the grounds of which we may appreciate the vulnerability of the company's financial structure by means of the ***net treasury***, and also the reflection of the interdependence between the financial structure of the company and the nature of its activity. Thus, the company is vulnerable if it appeals to financing its activity, mostly by contracting short term bank credits, aspect reflected by the comparison between the *variation of the working capital* and *the variation of the working capital needs.* The functional balance sheet allows the analysis of the company's activity from the perspective of its *activity continuity*. *The working capital needs* emphasize those cyclic needs that cannot be financially covered from temporary and permanent renewable resources within the same exploitation cycles and, for this reason, it is considered the most important ratio of the functional balance. Examining this ratio allows the quality analysis of the exploitation activity that needs to balance the cyclic needs from the cyclic capital resources and when these are not covered, the non financed part should be smaller or at least equal to the functional working capital. Therefore, when the exploitation activity shows deficiencies, we may reach a functional imbalance with consequences on the company's treasury. The study aims at establishing a *diagnosis on the financial situation of* **SC INTERLINK GROUP SRL,** from the point of view of the financial balance, of the company's liquidity and solvency, by means of the functional balance sheet.

2. The Analysis of the Financial Balance of SC INTERLINK GROUP SRL

To have an image on the evolution in time of the company's activity, we processed data from the accounting balance sheets afferent to the years 2008 and 2007 and transposed into functional balance sheets.

Accounting balance sheet on december 31ST 2008 [lei] Table 1

ASSETS	GROSS	AMORTIZATIONS AND ADJUSTMENTS	NET	LIABILITIES	
FIXED ASSETS	70,907,155	28,695,587	42,211,568	EQUITY	25,248,486
Establishment expenses Research, development expenses Commercial fund Constructions Equipments Equity investment and immobilized debts	792,642 24,276,274 35,220,464 10,617,775	83,445 11,706,320 16,905,822 -	709,197 12,569,954 18,314,642 10,617,775	Shared capital Reserves Profit and loss (loss) Profit distribution Provisions	14,451,788 9,103,484 1,773,872 80,658
CURRENT ASSETS	22,359,192	644,092	21,715,100	PROVISIONS	32,199
Stocks Outstanding debts – clients Disposable funds	8,542,293 12,786,503 1,030,396	36,693 607,399	8,505,600 12,179,104 1,030,396	Risk provisions	32,199
REGULARIZATION ASSETS	59,973		59,973	DEBTS	31,547,304
Prepaid expenses	59,974		59,974	Financial debts Suppliers Tax and social debts	9,920,323 9,928,370 11,698,611
				REGULARIZATION ACCOUNTS	7,158,653
TOTAL ASSETS	93,326,321	29,339,679	63,986,642	TOTAL LIABILITIES	63,986,642

Functional balance sheet on december 31ST 2008 [lei] Table 2

USES	**AMOUNTS**	**RESOURCES**	**AMOUNTS**
STABLE USES	**70,907,155**	PERMANENT (STABLE) RESOURCES	**54,588,165**
Gross non current assets out of which:	70,907,155	Own resources out of which:	54,588,165
Non current assets in leasing		Non current assets amortization	28,695,587
EXPLOITATION USES	**21,328,796**	Price differences	644,092
Stocks (gross values)	8,542,293		
Outstanding debts (gross	12,786,503		

values)			
USES OUT THE EXPLOITATION	**59,974**	*Foreign resources out of which:*	**9,952,522**
Prepaid expenses	59,974	Risks provisions	32,199
ASSETS TREASURY	**1,030,396**	Average and long term financial debts out of which: debts related to the non current assets in leasing	9,920,323
Disposable funds	1,030,396	Deferred taxes for provisions	
		EXPLOITATION RESOURCES	**15,164,418**
		Debts to the suppliers	9,928,370
		Tax debts	5,236,048
		RESOURCES OUTSIDE EXPLOITATION	**7,158,653**
		LIABILITIES TREASURY	**6,462,563**
TOTAL USES	**93,326,321**	TOTAL RESOURCES	**93,326,321**

A. Horizontal Analysis of the Functional Balance Sheet

Global net working capital = Stable resources – Stable uses =
=(Equity + Average and long term loans) – Non current assets (1)

$$Working\ Capital = (54588165 + 9952522) - 70907155 = -6366468$$

Working capital needs =Exploitation needs and outside the exploitation – Exploitation resources and outside the exploitation (2)

$$WorkingCapitalNeeds = (21328796 + 59974) - (15164418 + 7158653) = -934301$$

Net treasury =Assets Treasury – Liabilities Treasury (3)

$$NetTreasury = 1030396 - 6462563 = -5432167$$

B. Vertical Analysis of the Functional Balance Sheet (or by Structure Ratios)

Financial Independence= (4)

$$\frac{Equity}{Total\,Liabilities} = \frac{54588165}{93326321} * 100 = 58.49\%$$

Indebtness degree= (5)

$$\frac{FinancialDebts}{LiabilitiesAccount} = \frac{9920323}{54588165} * 100 = 18\%$$

Credits contribution to forming total resources (global indebtness degree)

Global indebtness degree= (6)

$$\frac{Credits}{Total\,Liabilities} = \frac{16382886}{93326321} * 100 = 17.55\%$$

C. Analysis through Combined Ratios

a. Ratios of solvency and liquidity

General solvency=

$$=\frac{Total\,assets}{ForeignCapitals}=\frac{93326321}{15164418}=6.15 \quad (7)$$

General liquidity=

$$=\frac{CurrentAssets}{TotalDebts}=\frac{21388770}{15164418}=1.41 \quad (8)$$

This ratio reflects the possibility of the current patrimony components to transform in a short period of time into liquidities to comply with the due payment obligations. We appreciate a favorable global liquidity.

Immediate liquidity=

$$=\frac{DisposableFunds}{CurrentDebts}=\frac{1090396}{15164418}=0.07 \quad (9)$$

The ratio's level must tend to a unity increase, resulting that the value of 0.07 is not satisfactory.

b. The ratios of the rotation of the component elements of the working capital needs

Stocks rotation= (10)

$$\frac{Average\,Stock\,Of\,The\,Tax\,Year}{AssetsAccount}*360\,days=$$

$$=\frac{7413254}{61810766}*360=43\,days$$

Rotation of the clients' credit= (11)

$$\frac{Average\,Clients\,Debts}{AssetsAccounts*1.19}*360\,days=$$

$$=\frac{7548885}{73554812}*360=37\,days$$

Rotation of the suppliers' credit= (12)

$$\frac{Average\,Suppliers\,Debts}{Purchases+ExternalServices}*360\,days=$$

$$=\frac{8531299}{74238810}*360=41\,days$$

Global ratio of the working capital needs (13)

$$\frac{WorkingCapitalNeeds}{AssetsAccounts*1.19}=\frac{-934301}{73554812}=-0.013$$

Accounting balance sheet on december 31ST 2007 [lei] Table 3

ASSETS	GROSS	AMORTIZATIONS AND ADJUSTMENTS	NET	LIABILITIES	
FIXED ASSETS	**50.356.622**	25.496.356	**24.860.266**	EQUITY	**20.970.714**
Establishment expenses Research, development expenses Commercial fund Constructions Equipments Equity investment and immobilized debts	792.642 20.112.999 25.511.706 3.939.275	4.653 10.691.326 14.800.377	787.989 9.421.673 10.711.329 3.939.275	Shared capital Reserves Profit and loss (loss) Profit distribution Provisions	14.451.788 6.165.836 353.090
CURRENT ASSETS	**23.655.275**	1.389.525	**22.265.750**	PROVISIONS	**44.147**

Stocks Outstanding debts – clients Disposable funds	6.358.169 6.387.584 909.522	37.261 1.352.264	6.320.908 15.035.320 909.522	Risk provisions	 44.147
REGULARIZATION ASSETS	**73.121**		**73.121**	DEBTS	**18.902.837**
Prepaid expenses	73.121		73.121	Financial debts Suppliers Tax and social debts	7.678.901 7.134.228 4.089708
				REGULARIZATION ACCOUNTS	7.281.439
TOTAL ASSETS	**74.085.018**	26.885.881	**47.199.137**	TOTAL LIABILITIES	**47.199.137**

Functional balance sheet on december 31ST 2007 [lei] Table 4

USES	AMOUNTS	RESOURCES	AMOUNTS
STABLE USES	**50.356.622**	PERMANENT (STABLE) RESOURCES	**47.856.595**
Gross non current assets out of which:	**50.356.622**	Own resources out of which:	47.856.595
Non current assets in leasing		Non current assets amortization	25.496.356
EXPLOITATION USES	**22.745.753**	Price differences	1.389.525
Stocks (gross values)	6.358.169		
Outstanding debts of the clients (gross values)	16.387.584		
USES OUTSIDE THE EXPLOITATION	**73.121**	*Foreign resources out of which:*	**2.452.833**
Prepaid expenses	73.121	Risks provisions	44.147
ASSETS TREASURY	**909.522**	Average and long term financial debts out of which: debts related to the non current assets in leasing	2.408.686
DISPOSABLE FUNDS	909.522	Deferred taxes for provisions	
		EXPLOITATION RESOURCES	**11.831.465**
		Debts to the suppliers	7.134.228
		Tax and social debts	4.697.237
		RESOURCES OUTSIDE EXPLOITATION	**7.281.439**
		LIABILITIES TREASURY	**4.662.686**
TOTAL USES	**74.085.018**	TOTAL RESOURCES	**74.085.018**

A. Horizontal Analysis of the Functional Balance Sheet

Global net working capital = Stable resources – Stable uses =
= (Equity + Average and long term loans) – Non current assets (1)

$$WorkingCapital = (47856595 + 2452833) - 50356622 = -47194$$

Working capital needs =Exploitation needs and outside the exploitation -Exploitation ressources and outside the exploitation (2)

$$Working\,Capital\,Needs. = (22745753 + 73121) - (11831465 + 7281439) = 3705970$$

Net treasury =Assets Treasury – Liabilities Treasury (3)

$$NetTreasury = 909522 - 4662686 = -3753164$$

B. Vertical Analysis of the Functional Balance Sheet (or by Structure Ratios)

Financial Independence= (4)

$$\frac{Equity}{Total\ Liabilities} = \frac{47856595}{74085018} * 100 = = 64.59\%$$

Indebtness degree= (5)

$$\frac{Financial\ Debts}{Liability\ Account} = \frac{2408686}{47085018} * * 100 = 5\%$$

Credits contribution to forming total resources (global indebtness degree)

Global indebtness degree= (6)

$$\frac{Credits}{Total\,Liabilities} = \frac{7071372}{74085018} * 100 == 9.54\%$$

C. Analysis through Combined Ratios

1. Ratios of solvency and liquidity

General solvency= (7)

$$\frac{Total\ Assets}{ForeignCapitals} = \frac{74085018}{11831465} = 6.26$$

General liquidity= (8)

$$= \frac{CurrentAssets}{TotalDebtse} = \frac{22818874}{11831465} = 1.92$$

This ratio reflects the possibility of the current patrimony components to transform in a short period of time into liquidities to comply with the due payment obligations. We appreciate a favorable global liquidity.

Immediate liquidity= (9)

$$\frac{DisposableFunds}{CurrentDebts} = \frac{909522}{11831465} = 0.07$$

2. The ratios of the rotation of the component elements of the working capital needs

Stocks rotation= (10)

$$\frac{Average\ Stock\ Of\ The\,Tax\,Year}{AssetsAccount} * 360\,days * * 360 = 43 days$$

Rotation of the clients' credit= (11)

$$\frac{Average\,Clients\,'\,Debts}{AssetsAccounts * 1.19} * 360\,days = \frac{6849030}{63370337} * 360 = 22\ days$$

Rotation of the suppliers' credit (12)

$$\frac{Average\,Suppliers'\,Debts}{Purchases + External\,Services} * 360\,days = \frac{5575514}{74238810} * 360 = 27\,days$$

Global ratio of the working capital needs (13)

$$\frac{Working\,Capital\,Needs}{Assets\,Accounts * 1.19} = \frac{-3705970}{63370337} = -0.058$$

Analysis Ratios Table 5

ANALYSIS RATIOS	YEAR 2007	YEAR 2008
Global net working capital [lei]	-47,194	-6,366,468
Working capital needs [lei]	3,705,970	-934,301
Net treasury [lei]	-3,753,164	-5,432,167
Financial independence [%]	64,59	58.49
Indebtness degree [%]	5	18
Global indebtness degree [%]	9.54	17.55
General solvency	6.26	6,15
General liquidity	1.92	1.41
Immediate liquidity	0.07	0.07
Global ratio of the working capital needs	-0.058	-0.013
Stocks rotation [days]	43	43
Clients' credit rotation [days]	22	37
Suppliers' credit rotation [days]	27	41

3. Conclusions

The financial analysis aims at reflecting the possibilities of long term and short term financial balance, in carrying out the continuous activity of INTERLINK GROUP SRL. The company shows a policy of developing its production capacities and activity diversification, registering a working capital lower than the working capital needs.

A. Horizontal Analysis of the Functional Balance Sheet

From the analysis carried out on the grounds of the balance sheet, we notice that the *net global working capital* registers negative values (normally, its values should be positive), resulting that the company no longer has the capacity to finance its exploitation cycle, or, in other words, the exploitation cycle is the one financing the stable allocations. The financing of a stable allocation through a cyclic resource generates financial problems when the activity is decreasing, circumstances reflected in the company's activity in 2008, compared to the year 2007. *The negative working capital* represents an **alarm** signal in the company's activity that lacks sufficient permanent capitals to ensure the financing of the non current assets. Practice has showed that, as far as the industrial companies are concerned, they should register values up to 1-3 monthly turnovers [3].

Additionally, we notice that in 2008 *the global net working capital needs* (-934,301 lei) registers a negative value that allows the financing of the negative global net working capital. *The negative working capital needs* may be explained by low stocks, by a longer term of the suppliers' credit and by a shorter clients' credit [1].

The factors influencing the working capital needs are the turnover, the term of the production cycle, (there is a manufacture term – manufacture cycle), rotation term of the stocks, (there are deadlines – clients and suppliers), the term of raw material, finite products and merchandises stocking, the difference between the term of recovering the outstanding debts and the deadline for the suppliers.

Therefore, *the exploitation working capital needs* depend on the rotation duration of its component elements, the values registered being, in the case of the *stock rotation speed* in 2008 at the same level as in 2007, and in the case of the *suppliers' and clients credit rotation* we registered an increase compared to the same year.

The working capital needs is the central element of the functional analysis that does not harmonize with the appropriate increase of the working capital and that determines problems at the treasury kevel.

The working capital needs represents the ***current balance*** of the company, while the *working capital* reflects its ***long term balance.***

The correlation between the working capital needs and the, the working capital and the treasury may be expressed as it follows [5]:

Net treasury = Working capital – Working capital needs

The company INTERLINK GROUP SRL registers a working capital smaller than the working capital needs, both in 2007 and in 2008, resulting that the company's financial situation is in a treasury imbalance, needing to appeal to short term credits or to overdrafts (credit balances of the bank accounts).

The treasury imbalances do not always mean insolvency and nonpayment risk.

The short term credits are accessed on the grounds of the activity analysis and they may solve the financing problem of a part of the working capital needs. Sometimes, appealing to short term credits may determine smaller costs that the established resources that, due to the variation of the interest rate, may become even more costly. Both in 2007 and in 2008 the company's treasury registers negative values, the analysis cases being the following:

- for 2007, **WC<0** and **WCN>0,** reflecting the situation of the bank credits covering part of the non current assets (WC<0), WCN and disposable funds (lower than the treasury credits), requiring a reconsideration of the financing structure;
- for 2008, **WC<0** and **WCN <0,** reflecting the situation of the permanent resources covering only a part of the non current assets WC<0, the rest being covered from short term debts (suppliers, clients advance payments) and current bank credits, imposing the rigorous analysis of the financing structure, as the **risk of the financial dependence on the outside** is high.

B. Vertical Analysis of the Functional Balance Sheet (or by Structure Ratios)

The ratios of the structure of the balance sheet liabilities (resources) among which we may remind: financial independence, the indebtness degree, the global indebtness degree help the appreciation of the financial balance by allotting financial resources to the needs (artificial capital).

As far the company SC INTERLINK GROUP SRL is concerned, the ratio of financial independence is of 64.59 %, in 2007 and in 2008 of 58.49 %, the recommended (optimal) increase being of 50%. We notice that compared to 2007, the company's financial independence is lower, yet the ratio's value is not worrying.

The indebtness degree as well as the global indebtness degree shows a certain independence from the company's creditors.

C. Analysis through Combined Ratios

The ratios of solvency and liquidity

The analysis of the solvency ratios reflects the long term stability and the short term and long term trustworthiness of the company's creditors. We notice that this ratio is almost at the same level in 2007 and in 2008.

The liquidity ratios complete the analysis by means of the solvency ratios, reflecting the company's abilities to face short term debts or total debts, by means of the stable resources. We notice that the ratio of the general liquidity is of 1.92 in 2007 (the ideal value is in the range 1.8 - 2), while in 2008 it decreases to 1.42, indicating a financial situation that starts having problems, idea also substantiated by the level of the ratio related to the immediate liquidity, that is much lower than the optimum value (considered in the range 0.8-1).

Ratios of the rotation of the working capital needs component elements

From the analysis of the working capital needs elements, we ascertain that the number of days of stocks renewal is similar to the year 2007, while the term of the commercial credit received from the suppliers' increases in 2008, phenomenon reflecting a more efficient collaboration.

The credit granted to clients in 2008 increased compared to 2007 and it is strongly connected to the increase of the suppliers' credit.

The ratios featuring the speed rotation of the assets and liabilities positions influence the financial performances of the company, by directly reflecting into the benefit and the economic and financial profitableness.

Therefore, it is necessary to determine the factors and the ways of accelerating the speed of the current assets, during all the phases of the economic circuit: supply, manufacture, sales.

The objective of the balance sheet is the one of accurately [7] present information on the company's financial position, on the capacity to adapt to the changes of the environment by means of resources, in the financing structure (debts and equity), as well as with the help of important economic financial ratios (liquidity and solvency).

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