

STATEMENT OF CASH FLOWS FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN ROMANIA

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Abstract:

In recent years, the number of small and medium-sized enterprises has increased considerably, according to statistics presented by the NIS. This was also stimulated by the emergence of national programs, such as the case of Startup Nation. But, many of them failed to remain in the market and remain competitive, going into insolvency. This aspect determined us to carry out a quantitative study based on a questionnaire addressed online to the owners of a number of 360 economic entities, in order to identify the cause of the insolvency determination. 85% of the responses received from respondents resulted in poor cash flow management and non-compliance with the business plan. The lack of historical background has led to a future forecast of cash flows from operating activities, investments or bad financing. Inadequate cash flows to repay loans, pay dividends, maintain the entity's operating capacity or make new investments were other issues reported. The research methodology is a descriptive one that aimed to achieve the objectives transposed in the questionnaire by formulating the questions. The two hypotheses considered were validated.

Key words: cash flows , small and medium enterprises, IAS 7, investment

JEL classification: M40, M41

1. INTRODUCTION

The concepts underlying the balance sheet and profit and loss account are well known and clarified. These are: the measurement of the values or a snapshot of the resources and obligations of the entity at a given time, respectively a summary of the economic transactions and the performance in a certain period of time. The third important component of the financial statements is the cash flow statement, a newer concept, which has evolved substantially since its inception. What later became the cash flow situation had as a starting point the reconciliation of changes in the resources of the company throughout the period, but in a totally different way from the one presented in the profit and loss account.

The most pronounced progress was made in America, during the years 1950-1960, where several concepts and formats were experimented. Also during this period one of the approaches was to source and use funds, although this reporting became mandatory only in 1971 when there were four ways to define funds including working capital or cash (current assets minus current liabilities).

A reason why those who drafted the financial statements did not embrace the concept of cash flow was that the accounting practice has long had an aversion to measuring operational performance on the basis of cash accounting. This reason was related to the respect of the concept of commitment accounting, which involves the recognition of incomes and expenses when they arise and which concerns the reporting of cash flows as a gateway to cash accounting. defined as the need for working capital, the funds included items such as receivables or payables, thus ensuring compliance with the basic characteristics of measurement with the help of accrual accounting. On the other hand, this approach failed to provide an image of the sources and uses of cash, information that would have constituted the basic core in assessing the liquidity and solvency of the reporting entity.

Ten years later, many acknowledged the existence of problems associated with the reporting of funds, including the requirement to present "all financial resources" used, according to which all major non-monetary transactions (and which did not involve funds), such as stock exchanges and of debt on assets, they had to be included in the fund picture. Eventually, these problems they drove a new requirement for cash flow reporting. In addition, elaboration of the

conceptual framework of FASB during the years 1970-1985 found the need and usefulness of predicting future cash flows. This accelerated the move from measuring the flow of funds to the cash flow, the third component of financial statements.

The cash flow situation became mandatory in the 1980s in America and immediately thereafter in the United Kingdom, with an approach that largely reflects the US standard, although there is a refinement of the classification scheme. The international standard adopted a year later than the one in the UK (both were revisions of previous usage and resource requirements) favored the simpler approach of the US model, but offered more flexibility, thus incorporating the point of British view, however, without encompassing the complex structure of the cash flow picture.

Today, a national and international consensus has been reached regarding the need for a cash flow chart financial statements prepared by economic entities.

2. LITERATURE REVIEW

The usefulness of cash flow analysis for correlating profit (loss) with cash; separating activities involving cash from non-cash, evaluating the ability of the company to fulfill its obligations to pay cash, evaluating cash flows for future activities (strategic cash-flow). [1]

According to some authors, cash flows denote the set of cash inflows and outflows and cash equivalents. Liquidity refers to cash and sight deposits. Liquidity equivalents are short-term financial investments with very high liquidity, which can be converted into cash and whose risk of change is insignificant. [2]

The interest for the cash flow situation is analyzed in the study of N. Farcane, S. Căpușneanu and S. Briciu [3]. The results show that there are differences between the opinions of the specialized personnel of the financial-accounting departments who have used the situation of the cash flows and those who have not used these situations, the difficulties encountered and the usefulness of the financial information provided in the decision making. They also believe that the information provided by the cash flow statement can be used to increase the quality and level of earnings, liquidity and financial flexibility and helps to predict cash flows. Cash flow information should provide a better indication of a company's liquidity level, as no asset is as liquid as cash.

According to Cars and Mills, the financial strength and weakness of an enterprise is best estimated by using a set of cash flow rates combined with traditional financial statements, balance sheet and profit and loss account [4].

Both Eierle and Haller argue that small businesses overestimate the benefits of accounting standards [5].

3. RESEARCH METHODOLOGY

This research revolves around the issue of insolvency of small and medium-sized enterprises regarding the provision of information generated by the cash flow statement. Studying the opinion of the managing owners of small and medium enterprises derives from the need to identify the usefulness of cash flows as well as its management.

The questionnaire contained a number of 12 closed-ended questions for the objectivity of the study. The hypotheses of this study were two in number, as follows:

Hypothesis 1: The causes of the insolvency of small and medium-sized enterprises are determined by a poor management of cash flows.

Hypothesis 2: the increase of the companies' profit is determined by the revenues realized, both constituting the cash flow of an entity.

The formulated objectives led to the validation of the hypotheses.

The respondents' answers had the following results: the economic entities generated cash mainly from the financial activity, from the operational activity resulted the contracting of the credits or the extension of the terms in making the payments to the suppliers.

4. CASH FLOW ANALYSIS AND PERSPECTIVES

IAS 7 outlines some of the cash flow benefits presented along with the entity's financial position and performance consisting of:

- providing an image of the company's financial base (including solvency and liquidity) including the timing of cash flows, the ability to adapt to ever-changing opportunities and circumstances.

The cash flow statement provides important information about investments and financing, cash in operation, information that cannot be extracted from the balance sheet, nor from the profit and loss account. Some additional information is provided by IAS7 (such as those relating to unused credit facilities or cash that represents an increase in operating capacity) or required by users of financial statements (such as cash held that is unavailable to be used.). Taken together, the cash flow statement, presentation requirements and recommendations provide the user with much broader information than the balance sheet and profit and loss account, on the position and performance of the company, as well as its likely future results. Provides users of financial statements with additional information, for the valuation of debts and equity, changes in the assets of a company.

Users receive information about the company's assets and liabilities, in case of presentation of comparative balance sheets at the end of each year. To either speculate on how and why the reported amounts varied from one period to another, or to calculate these elements themselves. But in the best case scenario, this "one-off" approach will calculate the net individual change (increase or decrease) of assets and liabilities and will link the corresponding items in the profit and loss account.

Table no. 1. Activities from the cash flow statement according to IAS 7

	Operational activities	Investment activities	Financing activities
Cash entries	<ul style="list-style-type: none"> - proceeds from the sale of goods and services - sale of loans, receivables or equity instruments classified as held for trading purposes - capital expenditure (dividends) - payment of suppliers of goods and services - payments for or on behalf of employees - tax payments - interest payments - the acquisition of loans, receivables or equity instruments classified as held for trading purposes 	<ul style="list-style-type: none"> - the sale of capital instruments issued by other companies and the profits related to these instruments - loans made and purchase of debt instruments issued by other companies - acquisition of equity instruments issued by other companies - acquisition of land and equipment 	<ul style="list-style-type: none"> - proceeds from the share issue - loan receipts (short or long term) - payment of dividends - redeeming their own shares - payment of the principal in the case of loans, including those related to the lease

Source : own processing

Although major changes in the balance sheet can be used to determine the implications for cash, this is not always possible. Certain immediate appearance of events (such as the acquisition of another entity together with its receivables, acquisition that will increase the assets of the reporting entity during the period, but without any connection with its clients) will not be able to be understood without other information and will it reaches erroneous interpretations, without the presentation of the cash flows

There have been many debates since the 1960s - 1970s regarding standardization in accounting, debates that led to the emergence of the cash flow situation. The main argument for the

cash accounting brought by the followers of this concept was that the arbitrary allocation, inherent to the concept of commitment accounting, is eliminated. For example, the cash flow resulting from operating activities, through the indirect method, is calculated by adjusting the net profit or loss of the period with items such as depreciation and provisions that have been calculated by the entity using various methods, different from a company to other. Therefore, standardization will be achieved by moving from a commitment accounting to a cash accounting and the results will be comparable between different companies.

An entity must report cash flows, using two methods: the direct method, whereby the main classes of gross cash payments and receipts are presented and the indirect method, whereby profit or loss is adjusted with the effects of non-monetary transactions, deferrals or past or future operating cash payments or cash receipts, revenue or expense items associated with cash flows from investments or financing.

Table no 2. Comparison between cash flows method

DIRECT METHOD	THE INDIRECT METHOD
<ul style="list-style-type: none"> - cash flows from the operating activity - receipts from operating activity - payments to suppliers - payments for operating expenses - corporate tax payments - payments from the operating activity 	<ul style="list-style-type: none"> - cash flows from the exploitation activity - gross profit - adjustments for depreciation, unrealized gains from exchange rate differences - interest expenses - operating profit before the change in working capital requirement - Increase of trade receivables - decrease of stocks - the increase of the commercial debts - cash from operation - interest paid - tax on profit paid - cash flows from the exploitation activity

Source : own processing

The formulas for the conversion of the various profit and loss items from commitment to cash accounting, for presentation by direct method are shown below for a production activity:

Net turnover + Balance of trade receivables – Final balance of trade receivables = Receipts from customers

Cost of goods sold + Final balance of stocks – Amortization = Payments to suppliers
Initial trade balance

Operating expenses + Initial balance of expenses incurred. – Amortizare = You pay expenses
Final balance expenses in advance. Final balance of expenses incurred
Initial balance of expenses in advance
Losses on receivables

From the above, it can be seen that the amounts to be included in the reporting of cash flows from the operating activity, when using the direct method, are calculated; however, there are usually no amounts that exist in the balance sheet and which should only be found and taken over in the case of cash flows. The additional effort required to use the direct method in reporting cash flows may be a contributing factor to the reduced popularity of this method for those who prepare financial statements.

The most widely used method of presenting cash flows from operating activities is the direct method also known as the reconciliation method. It notes the differences between net operating

income and cash flow. the written representation starts with the net profit or loss, an indicator taken from the profit and loss account. The use of the indirect method in the statement of cash flows shows the changes in most components of current assets and liabilities. For example, depreciation and impairment are expenses that reduce net profit, without affecting cash.

The statement of cash flows drawn up by the indirect method illustrates the changes that have occurred in most components of current assets and liabilities. Changes in stocks, trade receivables or trade liabilities are used to calculate the cash flow from operating activity. Although most of these adjustments are obvious, certain variations require more in-depth analysis.

IAS 7 provides yet another alternative to how cash flow calculation from operating activity is presented. This is called the modified indirect method. According to this variant of the indirect method, the starting point is not the net profit, but the income and the expenses, as they appear in the profit and loss account. In essence, this approach is almost the same as the direct method, with two higher details: income and expenses of the period. According to US GAAP, this method has no equivalent.

5. CONCLUSIONS

When expenses are not supported by receipts, cash flow management is of major importance. Performing an analysis over a time horizon is absolutely necessary in such cases. The companies' forecasts must be made both in the short term (monthly, quarterly) and in the medium or long term, at an interval of 2-5 years. To avoid insolvency, financing in fixed assets with a longer economic duration through short-term loans can be disastrous for any economic entity.

Another problem identified is that the lack of cash flow prevents them from paying their taxes due to the non-timely receipt of the invoice from the beneficiaries. Decreased cash flow can also affect the activity of business partners.

Regarding the two methods used the advantage of direct method users is a better understanding of the relationship between the entity's net profit and cash flows. Making the payment of expenses is highlighted as a cash outflow and is deducted from the receipts, making it easier for the user to recognize the receipts and payments made.

The major disadvantage of the indirect method lies in the difficulty of the user to understand the information presented. This method does not show how cash entered or was paid. Only adjustments to recognized income based on commitment accounting are presented, so in some cases these adjustments can be confusing. Regardless of the methods used, entrepreneurs want standardization, an indicator of the value for the safety of future cash flows as well as the impact of price changes.

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