

# The Usefulness of Financial Statements in Making Financial Diagnosis

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## Abstract

*Our research aims to develop an analysis of the usefulness of financial statements and financial investment in making the diagnosis. Financial analysis is by definition an activity that performance condition is diagnosed entity of the financial year. Financial analysis shall be determined by strengths and weaknesses of financial management based on which will underpin future strategy of the entity to maintain and develop it into a competitive environment.*

*Results of financial analysis depends on the quality, accuracy, relevance and effectiveness of economic information collected and processed. The primary sources of information for financial analysis are the financial statements, which are considered as raw material in the analysis.*

**Key words ;** investment diagnosis. financial diagnosis, financial statements, balance, financial solvency ratio

**J.E.L. classification :** G 32, M 41, G 39

## Introduction

Financial analysis aims to highlight, on the one hand the processes of obtaining and maintaining financial equilibrium in the short, medium and long on the other phases of accumulation of funds, the profitability of the business entity. The balance sheet summarizes the status of de facto entity at a time in terms of heritage, while income statement summarizes the outcome of economic and financial flows of revenues, costs and expenses over a period of time, quarterly or annually. As part of the financial statements, attention has been focused more on the balance sheet, called statement of financial position. This is because the report is a logical starting point for assessing the financial position of an entity. Balance offers a number of valuable information about a business, particularly when assessed as a period of several years and in relation to other financial statements. (Monea, 2013,p.150) Fundamental analysis of the balance sheet through specific techniques may reveal an economic diagnosis of the financial position. For delimitation slight difficulties facing an economic entity, any review must be based on the calculation and interpretation of economic and financial indicators. Balance sheet analysis will achieve financial balance. For this purpose it is determined share of each item in the balance sheet structure to define indicators characterizing the financial balance based on the balance sheet.

Results of financial analysis depends on the quality, accuracy, relevance and effectiveness of economic information collected and processed. The primary sources of information for financial analysis are the financial statements, which are considered as raw material in the analysis. Analysis indicators were chosen from the research literature domestic and foreign , (Trenca 2006,ch 1), (Pierre 2004, ch1) (Lezeu 2004,ch1), (Chirila and Droj 2010,p348) and (Brealey et. Al 2004,ch1). Analysis and our research has focused on the airline industry in this area strategic challenges relate both to economic performance, maintaining entities markets highly specialized in a report attractive cost and quality products, but at the same time, the entity will have a high efficiency in terms of global issues on exhaustible resources. Therefore, it is necessary to focus on production processes to be continuously improved, upgraded entity to be able to adapt to the highly competitive environment.

Stakeholders domestic industry Romanian aviation should trigger the creation of a so called "pole national aviation industry" that creates opportunity for our country to be integrated into strategic partnerships with large companies and international corporations in the field ensuring in this way and development sustainable development of the country and national economy with positive impact on national GDP.

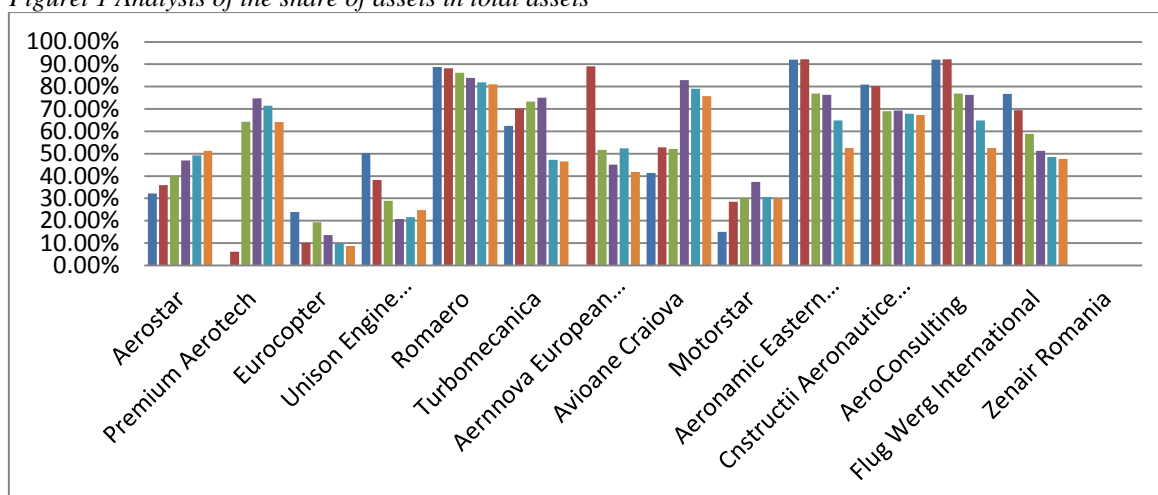
## Financial Diagnosis

The financial statements provides valuable information about the financial position and performance of the entity, the success of its operations, policies and management strategies. Derived data are useful for a range of stakeholders, helping in the decision process: shareholders, managers, investors, lenders, regulators as mentioned in previous studies . Financial analysis field was expanded recently by studies of business entity in line with the trends and sector development. However, analyzing all information in the context of a competitive field leaves its mark on case studies related to the set of financial statements. Due to the complexity of the information provided by financial analysis decision-making process, it is considered to be a strategic diagnostic input.

### (1) The analysis of balance sheet assets and liabilities

The most important attributes that reveal the usefulness of the information provided by financial statements are considered to be qualitative characteristics of information in financial statements (OMPF 3055/2009, 1802/2014 OMPF). Financial analysis aims to highlight, on the one hand the processes of obtaining and maintaining financial equilibrium in the short, medium and long on the other phases of accumulation of funds, the profitability of the business entity. The balance sheet summarizes the status of de facto entity at a time in terms of heritage, while income statement summarizes the outcome of economic and financial flows of revenues, costs and expenses over a period of time, quarterly or annually. As part of the financial statements, attention has been focused more on the balance sheet, called statement of financial position. This is because the report is a logical starting point for assessing the financial position of an entity. Balance offers a number of valuable information about a business, particularly when assessed as a period of several years and in relation to other financial statements. (Monea,2013). As main indicators monitored was particularly dynamic on the balance sheet: assets, current assets (overall and ranked inventories, receivables and other similar) and accrued expenses. From the following chart notes that the share of assets is highly variable and can not be identified a pattern.

Figure 1 Analysis of the share of assets in total assets



Source: own processing based on the data from [www.mfinante.ro](http://www.mfinante.ro)

By introducing a new variable, it appears that, at companies with majority domestic capital, with increased turnover, the share of assets decreases around 40%. EADS subsidiaries in Romania exception: Premium Aerotec, and Unison Engine Components Eurocopter. The large share of assets in the entity means reduced flexibility, which is a wrong conclusion. The activity of the

company requires possession of heritage buildings and land used in the production cycle. So management entities prefer to take little flexibility to achieve increased stability. Regarding stocks, highlights a supply policy and good storage. Stocks of raw materials and finished products remain modest limits around 10% of total assets (see Table). But there are some entities which have a significant share of stocks: MOTORSTAR (40% -50%) and Romania Zenair (80-90%).

Zenair Romania is a firm that offers kits for ultralight aircraft, engines and other aircraft parts. This entity holds assets in its property assets, which affects profit or loss.

Table 1 Share of current assets to total assets

	2008	2009	2010	2011	2012	2013
<b>Aerostar</b>	32,449%	24,779%	15,188%	19,975%	20,465%	20,302%
<b>Premium Aerotec</b>		0,00%	6,10%	10,78%	21,09%	17,78%
<b>Eurocopter</b>	10,59%	46,36%	46,77%	22,75%	35,21%	13,76%
<b>Unison Engine Components</b>	11,57%	39,16%	2,43%	3,23%	4,53%	3,77%
<b>Romaero</b>	2,22%	2,12%	1,95%	2,07%	2,54%	2,99%
<b>Turbomecanica</b>	8,71%	5,64%	3,82%	4,61%	3,49%	1,97%
<b>Aernnova European</b>		3,90%	22,24%	51,94%	38,43%	51,96%
<b>Avioane Craiova</b>	12,47%	7,73%	2,20%	0,12%	0,18%	0,65%
<b>Motorstar</b>	28,30%	14,10%	12,58%	13,22%	10,40%	11,59%
<b>Aeronamic Eastern European</b>	6,35%	6,16%	23,06%	23,47%	33,40%	47,20%
<b>Construcții Aeronautice (IAR)</b>	4,31%	5,42%	3,06%	3,17%	3,27%	3,26%
<b>AeroConsulting</b>	6,35%	6,16%	23,06%	23,47%	33,40%	47,20%
<b>Flug Werk International</b>	79,63%	90,58%	95,85%	84,72%	88,72%	99,23%
<b>Zenair Romania</b>	11,24%	12,29%	11,79%	9,93%	10,15%	12,57%

Source: own processing based on data from [www.mfinante.ro](http://www.mfinante.ro)

Table 1 shows the share of receivables in total assets which is found typically below 30%, which means that there are major deficiencies in their collection. However, Flug Werk Asset International has a share of over 75% each year analyzed what may signal difficulties in their collection or just an aggressive market expansion. Treasury Asset Value Total current assets have a moderate share throughout the period analyzed hovering, usually below 10% of total assets. A special case is given by the company Eurocopter showing a fluctuating situation of treasury accounts (10% -50%). This may be due to less viable investment perspective, the company had to incur opportunity costs of excessive liquidity.

Aeronautical industry segment shows an unusual feature on total capital and debt structure. Three categories can be identified to support this observation:

- a. Companies with a positive total capital and its positive trend .:
- b. Companies showing a positive total capital, but declining: Due to economic factors, listed entities have had to adapt their policy to attract funds, appealing and foreign investors.
- c. Commercial companies that exhibit negative total equity. If not receive financial assistance, these entities will exit the market.

Assessment of their capital companies identify the elements of nature attracted funds to finance business and results. Analysis of the implementation of investment programs and the marketing of semifinished and finished products materialized in total capital assessment. Thus, one can see entities that have stability throughout the period under review as Aerostar, Premium Aerotec, Eurocopter, Unison Engine Componentes, Romaero Turbomecanica, MOTORSTAR, Aeronamic Eastern European and AeroConsulting. In this category we note in full, two types of organizational behavior, categorized by risk aversion: entities that have expanded using its own funds and companies that have turned to foreign funds. But no matter how the situation is viewed funds raised, there is an increasing rate of indebtedness at the sector level, which could hide instabilities marketing process, either from consumers or the entity itself.

## (2) Analysis of rates

The methodological approach to determine a common set of indicators based on national requirements for aviation companies required to consider only the common set of indicators that accept both academically and in terms of practical use. Analysis indicators were chosen from the research literature domestic and foreign (, Trenca 2006,p.152), (Pierre(2004 ,ch 2), (Lezeu 2004, ch1), (Chirila and Droj 2010 ,p.350) and ( Brealey et. Al ,2004 ,ch 1) ). In this study identified twenty indicators were selected only four. The first indicator, the rate of global financial autonomy (RAFG) - Indicates the percentage of the company's assets that is financed from own resources. It can be calculated using the following equation:

$$R_{AFG} = \frac{Capital}{Debt} \times 100$$

Table 2 Rate of global financial autonomy

(%)	2007	2008	2009	2011	2012	2013	2014	2015
<b>Aerostar</b>	226.26	260.39	213.49	417.58	586.60	565.94	318.56	310.98
<b>Eurocopter</b>	141.72	139.01	151.82	50.14	202.47	108.76	112.40	71.23
<b>Unison Engine Components</b>	11.52	184.80	328.31	354.30	581.23	489.98	1096.47	881.80
<b>Romaero</b>	1097.83	1112.89	1154.53	1013.70	796.62	645.24	385.41	328.21
<b>Turbomecanica</b>	321.06	196.54	110.94	122.85	106.71	74.97	40.12	32.32
<b>Avioane Craiova</b>	34.20	0.69	-45.50	73.16	81.03	51.51	-57.06	-63.21
<b>Motorst</b>	19.18	23.37	39.69	31.48	47.17	46.99	59.11	60.04
<b>Constructii Aeronautice</b>	0.10	37.60	48.46	58.24	55.31	59.83	-63.79	-66.31
<b>Aero Consulting</b>	67.35	65.68	88.12	57.78	32.37	35.39	37.10	44.05
<b>Flug Werk International</b>	83.23	1.26	10.96	6.43	4.68	1.28	-3.09	-6.44

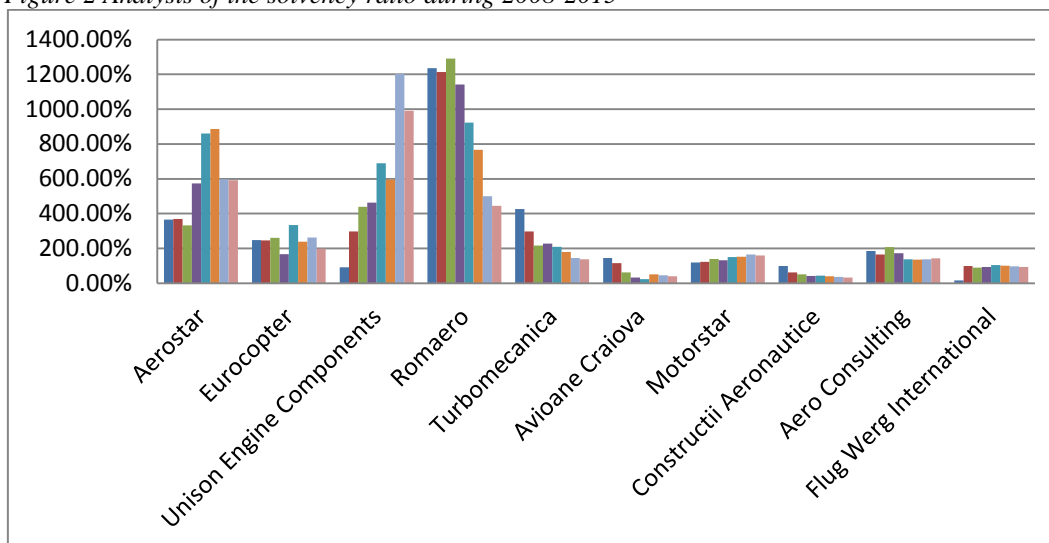
Source: own processing based on data posted on [www.mfinante.ro](http://www.mfinante.ro)

Aerostar RAFG describes a firm policy of financial autonomy, except stages of crisis and post-crisis, when it increased to almost 400-500% due to debt reduction. Eurocopter SA, a subsidiary of conglomerate Airbus recorded a rate of between 100-150%. The only notable development was recorded in 2008-2009 due to capital flows. Equity value of a company is considered an indicator of its financial health. As recorded negative equity due to losses, companies must either increase the share capital or to initiate bankruptcy proceedings in accordance with Law 31/1990. Between 2012-2013, the following companies namely aviation Airplanes Craiova, Civil Aviation and Flug Werk Internationall have an overall negative financial autonomy (RAFG). These companies have debts outstanding. Loss generates, in turn, lack of liquidity, as a result, to survive, the entity will be delayed or will not make payments to its suppliers and will appeal to loans. Finally, companies exemplified in positions 9-14 of the Table no. 2 also identified entities from the position below market does not present a stable trend, the effect of environmental factors being too strong. Another indicator is chosen for analysis of the solvency ratio. It shows to what extent the total debt covered by the company's total assets and, therefore, reflects the guarantee that they creditors and the company's creditworthiness.

$$R_{SLV} = \frac{Total\ assets}{debt} \times 100$$

As can be seen in Graph 8, the company with the highest solvency rate over the analysis period Romaero SA, a company with a well known history, currently occupying the fourth position in the sector. Slowly, will trade places with Unison Engine Components which recorded an upward trend solvency.

Figure 2 Analysis of the solvency ratio during 2008-2015



Source: own processing based on data posted on [www.mfinante.ro](http://www.mfinante.ro)

Taking into account economic factors such as developments in market share, related to market dynamics can define three levels. Therefore, we see companies that develop heavy periods (Aerostar, Unison Engine Components, MOTORSTAR), those who are affected to a small extent as such (Eurocopter, Aeroconsulting, Flug Werk International) and, thirdly, entities that have reduced creditworthiness (Romaero Turbomecanica, Civil Aviation).

The next single indicator, return on assets, reflects the difference between the economic result (net profit, known in the literature as EBIT - Earnings Before Interest and Taxes) and the assets used to achieve it (Pierre, 2004, ch 3).

$$ROA = \frac{\text{Net profit}}{\text{Total Assets}}$$

Return on assets is calculated using net income. More than 40% of companies operating in the aviation industry were negative in terms of financial results. As a result, only four entities present a more realistic development index: Aerostar, Eurocopter, Unison Engine Components and MOTORSTAR.

Although Aerostar SA is the market leader in the years 2006-2012 (2013 benchmarking is given by Premium AEROTEC - overlooked because operational period -was founded in 2009), ROA index shows a downward trend. In other words, total assets increased faster than net profit. At the opposite pole lies MOTORSTAR SA, where the return on assets increased to 0.07 from 0.30 eight years.

Unison Engine Components Eurocopter presents positive values of the index, but their only vary between 0.04 and 0.15 to 0.04 and 0.21 for Eurocopter and Unison Engine Components.

Eventually return on equity was valued at sector level. Known in the literature as "return on equity", this indicator shows the efficiency of shareholders on invested capital. Given the number of stakeholders (shareholders or potential investors), using the index, we can say that is one of the most important indicators of profitability. Followed by calculation formula is as follows:

$$ROA = \frac{\text{Profit net}}{\text{Capital}}$$

As shown in the analysis performed on the rate of financial return, it is noted that the results are similar to those of return on assets: four out of ten companies have positive results over the eight years. Aerostar SA a fall in investment earnings relevance in decision making. On the other hand, companies like Eurocopter, Unison Engine Components and MOTORSTAR have managed to improve the relationship between company and customer and therefore increase return on equity.

## Conclusions

In conclusion, this case study is performed in dynamic and describes a diagnosis on background financial companies in the industry and therefore concludes that this analysis can reveal representation of financial position, resulting relevance and usefulness studies the Balance Sheet.

Although the techniques and practices regarding financial diagnosis presented in this paper do not express as primary feature completeness, in practice, the dynamic analysis of key balance sheet items, the rates of financial liquidity, solvency and profitability, provide a true and fair view of the financial position economic entity.

Results of financial analysis are especially influenced by the quantity, quality, reliability and efficiency of financial and economic information. (OMPF 3055/2009)

The analysis of financial data is reported in the balance sheet for an economic entity, under a financial diagnosis by determining specific indicators of economic analysis and financial statements

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