THE ACCOUNTING RESULT BETWEEN THE RETURN INFORMATION AND THE LIQUIDITI INFORMATION OF THE ENTITY

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Abstract:

The financial position of an entity is influenced by the economic resources it controls, its financial structure, its liquidity and solvency, as well as its ability to adapt to the changes in its operating environment.

The information about the economic resources controlled by the entity and its capacity in the past to change these resources is useful to predict the entity's ability to generate cash or cash equivalents in the future. The information about the financial structure is useful for anticipating the future lending needs and of the way in which the profits and the future cash flows will be distributed among those who have an interest in the entity; these are also useful for anticipating the entity's chances to receive funding in the future. Therefore, the information about liquidity and solvency is useful to predict the entity's ability to honour its outstanding financial commitments and determine the entity's results at the end of the taxable year.

Keywords: *entity, liquidity, solvency, accounting result.*

JEL Classification: *M4*

The financial position of an entity is influenced by:
- the economic resources it controls;
- the financial structure;
- liquidity;
- solvency;
- the ability to adapt to the changes in its operating environment.

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The information about liquidity and solvency is useful to predict the entity's ability to honour its outstanding financial commitments.

Liquidity refers to the availability of cash in the near future, after taking into account the financial obligations associated with this period.

Liquidity also refers to receivables, stocks, tradable financial instruments, other assets, which are expected to be converted into cash in less than a year (the current assets are not usually very profitable, but they tend to give liquidity and safety to the operations of an entity).

Moreover, liquidity means all the money available to an entity to make payments on time.

Solvency refers to the availability of cash over a longer period in which the outstanding financial commitments are to be honoured.

Solvency is the ability of a trader to pay the debt that he/she has to a creditor, at the period for payment settled in advance.

In other words, solvency is the ability of an entity to meet the medium and long-term maturities and it depends on the size of these liabilities and the cost of borrowing.

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An entity that spends more on investment and consumption than it collects from the sale of the production begins to exhaust its different ways of credit. The credit cost is bearable to cover the interim cash need, but it can become prohibitive when it comes to sustainable financing.

The inability to regulate the trades made, after the entity has used all the resources of credit and of recovery of the liquidity, it can lead to stopping the payments and placing them in a situation of recovery or judicial liquidation.

The state of incapacity could be based on three origins:

- insufficient economic viability;

- errors of management;

- fragility of the financial structure.

A poor **economic return** limits the entity's ability to renew its equipment, to promote new products, to recruit qualified employees etc. Progressively, the business deteriorates; the funding needs cannot be met except solely by excessive debt, whose cost adds to the already excessive expenditure and the fall spiral continues. In this case, the weak performance of the entity is the cause of the liquidity crisis.

The decrease of the economic profitability may also be the consequence of management errors. In this case, for example, the entity that supports major fixed expenses, engaged in favourable periods of times and that have not foreseen the possibility of recovery in case of reduction in the activity, when it occurs, it will preserve a higher cost structure of the business opportunities. The professional competence of the firm was not emphasised and it is the victim of a management error by over-sizing.

Furthermore, a very high dependence on a large customer places the providing entity at his/her good will regarding the payment. This is commonly found in the case of small entities. Diversification of the clients reduces the risk of illiquidity.

But the lack of means of payment is not only the consequence of a crisis of the operating conditions. An entity may be destabilised in terms of financial structure, without being destabilised economically at the same time, but the rapid economic growth can give fragility in financial terms, unless otherwise provided for the increase of the need for the working capital or there has been a change in the size of the entity under the action of social capital growth.

Such entities, economically sound but financially fragile can seek investors to recover their treasuries, but this must be done before the financial difficulties have repercussions on the economic performance.

Therefore, an entity may have economic performance, but it may have a financial end as a result of the liquidity deficit.

Hence we can conclude that between the beneficiary capacity and liquidity there is no mechanical relationship. It is not enough only to pursue the economic profitability indicators, it is necessary to ensure the liquidity of the company in its quality of particular dimension of the financial management.

The notions of liquidity and cash flow/treasury need to be well-defined because they are subject to several accounting measurements.

Regarded is an asset, treasury is an investment. A slow collection or placed shortly after, it offers a return a priori lower than the productive investment of the entity.

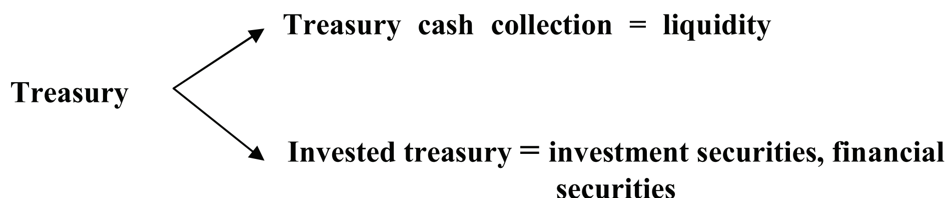
This brings up two restrictions:

- on the one hand, the entity must also provide the liquidity required to its transactions;
- secondly, it must make profitable its assets.

A first component of the treasury is the revenue that has not been placed, that is to say the existence of liquidity.

A second component re-covers the financial asset more or less fluid and it is represented by the treasury invested.

Figure 1. Components of the treasury



Source: personal contribution.

There is often confusion between treasury and liquidity. Treasury is calculated from the balance sheet items (BSI) indicating an instantaneous value on the closing costs date.

The liquidity of the entity is the result of the input flow and the output one of the money at different times.

On the other hand, the Treasury calculated starting from the balance sheet items does not reveal its origins. You cannot put the same verdict if the treasury is linked to high indebtedness, to foreign capital intake or to self-financing. The liquidity risk of an entity is assessed differently just as the treasury is ensured by recurring operating flows or by external resources. From this point of view, the verdict considers, particularly, the cash flow surplus resulting from the operating activities.

So the notion of Treasury is variable, depending on the circumstances and the terms in which it is addressed. The treasury accounting measures meet the specific definitions, regarded as collections, stable amounts of liquidity and quasi-liquidities preserved to ensure transactions.

If we consider the image of financing, the net treasury cash is given by the sum of the deposits available, except the current bank loans (the balance of the current account credit), which means that the investment securities are included in the non-operating receivables.

An entity's financial result includes the income and the expenses, regardless of their financial regulation. Along with the revenues, the reversals of the provisions are included and certain transfers of expenses, while along with the expenses the amortisation and the provisioning are included, as well as the value of the assets transferred. If this accounting result is an economic result, it is also interesting to calculate a treasury result or a cashable result. This is the meaning of the self-financing capacity (SFC).

The accounting result (the gross result of the taxable year or the result of the taxable year before taxation) is calculated taking into account the requirements of accrual accounting and respecting the accrual principle.

The accounting result = Total revenues – Total expenses

The gross result of the taxable year corrected with the tax deductions and the non-deductible expenses from a tax perspective allows obtaining the tax result (taxable profit or tax loss).

The tax result = The accounting result – Non-deductible income + Non--deductible expenses

Thus, based on all the information relating to: the economic resources it controls; its financial structure; liquidity; solvency; its ability to adapt to the changes in which it operates, one can determine the accounting result, which can also be influenced by the information mentioned.

Conclusions:

The users of the accounting information are not only satisfied with the information in the balance sheet and in the profit and loss account. On the one hand, because there is also interest in the evolution of the financial market regarding the situation from the beginning of the year and, secondly, because the use of accrual accounting generates the "hypothetical" size of the entity's performance.

Romanian accounting is connected to taxation. The balance sheet is meant for the personal needs of information and for third parties (except the state), without taking into account the fiscal constraints, but it is very necessary to determine a balance sheet meant for the IRS, to obtain the taxable (fiscal) result there is some extra-accounting processing required.

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