

THE ANALYSIS OF FINANCIAL EQUILIBRIUM IN THE CONTEXT OF ACCOUNT GLOBALIZATION

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Abstract: Generally speaking, the economic-financial equilibrium in firms is realized when one fully recuperates the means that are consumed and respectively when the incomes are equal with the expenses. Such a perception has a reducing character because it does not stress the relation of the ensemble with the components of the entire balance, with its partial condition.

The economical equilibrium reflects the state of concordance between the independent sides of production, concordance necessary for the normal development of the economical processes at macro and microeconomical levels.

The development of the enterprises is fundamentally bond of the assurance of the financial balance which is a part of the economical balance worth expression.

The financial balance reflects the equality and the correlations between the necessary of financial funds and the possibilities of making this funds. This balance is depending on the state and moving of patrimony.

The assurance of the financial equilibrium represents an essential condition in order to obtain a profitable activity and the achievement of this financial equilibrium can be obtained only through a rough and continuous moitorization of the lacks of balance that manifests in the current activity of the firm.

The balance can be dimensioned with mathematical models, but it must not be limited only at these ones for not ignoring the qualitative factors which provokes the endogen variability.

The new means of approaching considering IFRS highly modifies **the means of approaching financial equilibrium from the nature of patrimonial financial equilibrium emphasizing the resources controlled by the short term enterprises.** The vertical form of the balance sheet assures the premises of an analyses of the patrimonial and financial **equilibrium** in dynamics.

In the new context of account globalization, the financial equilibrium takes new valences and the following **forms:**

- The financial equilibrium achieved with the **assurance of the capacity for payment debts in short term and also in long term**, cuantified with the help of the indicators for the **liquidities and solvabilities.**

- It is firstly stressed the patrimonial financial equilibrium at the level of the exploitation with the help of the indicator for **working capital** which also appears calculated in the balance sheet structures. The least important are, if we consider the importance, the own equity which are being appreciated as a rezidual value that can finance the investments of the entity.

- It is emphasized the achievement of the **financial equilibrium at the level of the administration of the resources controlled by the enterprise at short term** and the equilibrium of the administration of the resources controlled by the enterprise at long term appears to be realised as a residual value. equilibrium at this level is emphasized with the utilisation of the **rotation rates** (the rotation of the actives, the rotation of the clients debts, the rotation from the debts of the contractor. This way we can identify this type of balance as a balance realized through the indicators for the activity (of administration).

- A special role is given to the **treasury**, the financial balance at the monetary level (between the earnings and spendings) being highly necessary for the assurance of a general **equilibrium** for the entire activity.

A. The analysis of the liquidities and solvabilities in enterprises

One of the most important means of achievement of the financial equilibrium of the enterprise is realized through the permanent assurance of the payment capacity of the enterprise both in short term and in long term period of time.

Generally speaking, the financial liquidity and solvability represents the capacity of the enterprise to face the falling due spendings. The liquidity aims at the short coordinates and the solvability aims at the long coordinates.

A1. The financial liquidity analysis

The IFRS norms claim that the financial liquidity represents a sign of the entity capacity to refund the short terms debts, measured through the evaluation of the circulatory active current debts.

In our opinion the financial liquidity represents the capacity of the element of the current active to transform themselves in liquidities to face the immediate falling due debts.

The state of the financial liquidity is influenced by a series of factors such as:

- A speed rotation of the claims that rises above the speed rotation of the debts;
- A speed rotation of the rising supplies;
- Positive fluxes of cash from exploiting activity, investing and financial.

The most important forms of financial liquidities are:

1. Current ratio (or general liquidity)
2. Quick ratio (or intermediary liquidity)
3. Effective liquidity

1. The current ratio (or general liquidity) relate current assets to current liabilities. The O.M.F.P no.1752/2005 calls this rate “The current liquidity”.

Current assets include cash, bank balances, marketable securities, account receivable, and inventory. *Current liabilities* include accounts payable, bank loans, that part of the long-term debt to be paid off during the coming year, taxes payable, and other accrues expenses.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100 \quad (1)$$

$$\left\{ \begin{array}{l} > 100 \%, \text{ excedental cover of general liquidity} \\ = 100 \%, \text{ equilibrium cover of general liquidity} \\ < 100 \%, \text{ deficcital cover of general liquidity} \end{array} \right.$$

Taking into consideration that rates of liquidity in general are rates of financial equilibrium, this equilibrium must not be statically understood but dinamically.

The rate of the general liquidity must evolve around 200% so, it must be in the financial assurance period of [150 %, 250 %].

2. Quick ratio stresses the current active capacity and less the supplies (in the quality of less liquid element of active) to face the current debts of the enterprise.

$$\text{Quick ratio} = \frac{(\text{Current assets} - \text{Inventory})}{\text{Current liabilities}} \times 100 \quad (2)$$

$$\left\{ \begin{array}{l} > 100 \%, \text{ excedental cover of intermediariy liquidity} \\ = 100 \%, \text{ equilibrium cover of intermediariy liquidity} \\ < 100 \%, \text{ deficcital cover of intermediariy liquidity} \end{array} \right.$$

Like the current ratio, the quick ratio, or acid test ratio, is meant to reflect the firm's ability to pay its short-term obligations, and the higher the quick ratio, the more liquid the firm's position. There are two danger in having too low liquidity position:

- One is not being able to pay obligations as they come due.
- The second is that short-term lenders may perceive the firm as being unable to meet its obligations and refuse to advance new credit.

3. The effective liquidity ratio measures the level in which the “cash and equivalent of cash” (TR) covers the falling due debts (DCR)

$$\text{Effective liquidity ratio} = \frac{\text{Treasury}}{\text{Current liabilities}} \times 100 \quad (3)$$

$$\left\{ \begin{array}{l} > 100 \%, \text{ excedental cover of cash and equivalent} \\ = 100 \%, \text{ equilibrium cover of cash and equivalent} \\ < 100 \%, \text{ deficcital cover of cash and equivalent} \end{array} \right.$$

The interval of financial safety being accepted for the **effective liquidity ratio** is [50 %, 100 %].

A high level of real (effective) liquidity ratio can be obtained in the folloqing conditions:

- The acceleration of the rotation speed of the debts
- The rising of the rentability of the exploitation activity
- The acceleration of the actives' participation level in the economical circuite
- The growth of the current actives' level in the total of active
- The growth of the cash elements and cash equivalents in the total of the enterprise current actives.

A2.The analysis of the financial solvability

According to IAS, the financial solvability refers to the disponibility of cash on a long time period after which the falling due financial commitments are to be honoured.

According to us, the solvability represents the capacity of the enterprise to pay the financial debts long termly, so it aims at a farther horizon of activity.Long time solvability analysis proposes itself to determin in each financial exercise wheater the enterprise is or is not in the danger of bankrupcy.

We can draw some **conclusions** such as:

1. Solvability refers to the level of credit coverment.
2. It represents the level in which the enterprises face the payment obligations.
3. Solvability represents a state of the financial equilibrium which stresses the size of the assets reported to the size of the credits.

The fact that influence the state of solvability are much more various and much more complex that those we mentioned at the state of liquidity.In this category we can also include the following:

- the rotation speed of the imobilized actives
- the monitory policy of the creditors
- the political and economical stability

The main models of the financial solvability:

- 1. The general financial solvability ratio;**
- 2. The solvability expressed through the financial dependency ratios;**
- 3. The solvability expressed through the level of The Time Interests Earned ratio.**

1. The general financial solvability ratio represents the enterprise capacity to refond to the falling due the current rates for the long and medium debts that were to be payed to banks and other financial institutions.

$$\text{General financial solvability ratio} = \frac{AB^f}{RC} \times 100 \quad (4)$$

$$\left\{ \begin{array}{l} > 100 \%, \text{ excedental cover of solvability} \\ = 100 \%, \text{ equilibrium cover of solvability} \\ < 100 \%, \text{ general insolvability} \end{array} \right.$$

Where:

- **AB^f** represents the assets recalculated meaning the assets from balance sheet that remained after the deduction of the current debts of the enterprise.We can remarce that this sign appears directly determined in the calculation of the balance structures by O.M.F.P no.1752/2005(at F post). RC represents the current rates of the financial debt on long and medium term which are to be paid.

The period of financial asurance in which it is appreciated a favourable level of the general solvability ratio is [80 %, 180 %].

2. Financial debts ratio measures the amount of debt and other expense obligations used in the farm business relative to the amount of owner equity invested in the business. The debts ratios provide an indication of the business's ability to repay all financial obligations if all assets were sold, as well as an indication of the ability to continue operations as a viable farm business after a financial adversity, such as a drought.

Financial ratios that measure solvability are calculated from balance sheet data, and are:

- Debt/Asset Ratio
- Equity/Asset Ratio
- Debt/Equity Ratio

► **The Debt/Asset Ratio** compares total farm liabilities to the value of total farm assets, and therefore measures financial position. This ratio expresses what proportion of total farm assets is owed to creditors.

The ratio is one measure of the risk exposure of the farm business; thus, is important in evaluating the financial trend of the business.

The goal of many farm business operators is to approach a debt free operation. A continual lowering of this ratio is a trend in that direction. The higher the ratio, the greater the risk exposure of the farm business.

So, it is favorably appreciated a descendent evolution of this indicator and the interval of the financial safety is [0%, 30 %].

In USA, the industry average of this ratio is 40 %.

► **The Equity/Assets Ratio** measures the proportion of total farm assets financed by the owner's equity capital, and therefore indicates financial position. The higher the ratio value, the more total capital has been supplied by the owner and less by creditors.

Dynamically analyzing it is favorably appreciates a **growth** of this ratio, the interval of financial safety being accepted is [30 %, 100 %].

► **The Debt/Equity Ratio** shows what extend the firm's economy resources are obtained from foreign capital.

It is favorably appreciated a descendent evolution of this indicator and there is a superior limit accepted that of 200 %. In other words the growth of the total debt must be at least two times bigger than the value of the personal capitals of the enterprise such as the general solvability of the enterprise is affected.

Creditors prefer low debt ratio because the lower the ratio, the greater the creditor's protection against losses in the event of bankruptcy. **Stockholders**, on the other hand, like the fact that leverage magnifies earnings.

3. Another means of expressing the solvability is reflected by **ability to pay interest – TIE (Time Interests Earned)**.

The Time Interests Earned (TIE) ratio is determined by dividing earnings before interest and taxes (EBIT) by the interest charge.

$$\text{The Time Interests Earned (TIE) ratio} = \text{EBIT} / \text{Interest charges} \quad (5)$$

The TIE ratio measures the extent to which operating income can decline before the firm is unable to meet its annual interest cost. Failure to meet this obligation can bring legal action by the firm's creditors, possibly resulting in bankruptcy. Note that earnings before interest and taxes, rather than net income, is used in the numerator.

It is favorably appreciated the level of the growth indicator and also an integral coverage of interests. In USA, the industry average of this ratio is 6 times.

B. The analysis of the financial patrimonial balance by help of the working capital indicator

In Romania, taking into account the evolution of the normalisation in the field of accounting we can distinguish two methods of approaching the financial balance at the patrimonial level:

♣ **The traditional method**, which existed before 1999 and which was centered on the assurance of a financial equilibrium firstly on long and medium term, determined through the level of the financing and investing activity the activity of exploiting appears as a secondary, residual activity, the realization of the financial equilibrium means the calculation of the financial circulating funds. To this objective of realization of a patrimonial financial equilibrium comes as an answer also the balance sheet form being one of the horizontal type.

♣ **The modern method**, approached after 1999, in the context of the demands of IAS which also has as a scope the assurance of the financial balance in short term, to the level of the exploiting activity, this having a central position in the presentation. The balance diagram is a vertical one and allows the offering of the information, firstly for the elaboration of policies at the exploitation activity. The policies and the strategies for the financial-investing activity develop only after these regarding current activity were settled. In the new accounting vision given by IAS/IFRS the financial equilibrium at the patrimonial level is realized at the level of utilisation and entity's current resources, calculating in this purpose the entity's working capital.

In order to calculate the working capital, we take into account the patrimonial mass with the instable character which rotates itself in periods less than one year, to which correspond in the balance's active the current actives and in the balance's passive the current debts.

In order to maintain the financial equilibrium at short-term the firm must assure the quality at the level of instable patrimonial mass, respectively the quality between the current actives and the current debts of the entity.

In practice the realisation of a financial equilibrium can realize through the subsidiation of only one part from the current actives and for the other part left to use the entity's stable resources. This is due to the fact that the risk associated with the current active cashing is bigger than the risk associated with the payment of the current debt.

Also, corresponding to the evolution in accounting normalization, in Romania the engaged capitals of the entity can be emphasized through two methods:

♣ **Traditional method**, used before 1999 according to which the engaged capitals can be calculated as a **sum** between the own equity to which we can add the debts of

the entity long and medium (to debts are also assimilated the risks and spendings provisioning and also the subvention for investments) after the relation:

$$\text{Capitalization} = \text{Own equity} + \text{Provisions for risks and expenses} + \text{Long term debts} + \text{Subvention for investment} \quad (6)$$

♣**Modern methods**, based on the IAS (US GAAP) approach, which appreciates the entity's capitals as a residual value of the associates in the entity's actives after the deduction of the current debts. In the same way the engaged capitals can be determined as a **residual value** that represent the remain part from actives after all the current debts are being paid, calculated as follow:

$$\text{Capitalization} = \text{Total assets} - \text{Current liabilities} \quad (7)$$

Taking into account the importance of the involved capital, this is emphasized during the balance structures (F position) according to the balance scheme approached through O.M.F.P no.1752/2005.

We can observe that will be a identical value for **Patrimonial Circulating Fund and Working capital, the difference are consist in modalities of determined (and also of interpreted), as follow:**

♣**Traditional method**, based on the reflection of a balance at the activity-investment level put into evidence by the Patrimonial Circulating Fund such as:

$$\text{Patrimonial Circulating Fund} = \text{Adjusted capital} - \text{Fixed assets} \quad (8)$$

The patrimonial Circulating fund represents the overplus on the permanent resources after the coverage of the permanent subsudiation needs of the entity and will be calculated extra balanced.

♣**In the modern methods**, equilibrium of current activity is primordial. In this case, The working capital (WK) is calculated based on the central part of balance sheet after the follow relation:

$$\text{Working capital (WK)} = \text{Current assets} - \text{Current liabilities} \quad (9)$$

So, working capital represent current actives permanently remained at a disposal of the enterprise meaning that current active that remain after the current obligation of the enterprise. This indicator is put into evidence through an explicite presentation in during the balanced structures (E position) according to the balance sheet form approved by O.M.F.P no.1752/2005.

The financial equilibrium analysis, according to the new balance sheet structure harmonized by IAS/IFRS has in view the short term financial balance made with the help of **working capital** and it is expressed this way:

a. **If WK = 0**, the enterprise has negative short term equilibrium stance because any dysfunction that that affects the state enterprises balance. In practice this situation can be found rarely.

b. If $WK > 0$ the enterprise has a short term financial equilibrium because it has a rate of assurance regarding the subsidization of the current actives, and this rate is realized on the account of one part firm the permanent capitals.

c. If $WK < 0$ the enterprise has a short term financial unequilibrium, meaning that the current debt subsidization both the current assets and one part of fixed assets. This situation produces major difficulties if we take a book of then form the eligibility term of current debts which is least than the illiquidity of immobilized actives and nevertheless a uncorellation of then rapport between the cashing and payments.

The realization of the short term (at the exploiting level) determined through the calculation of the work capital has a direct impact on the realization of the long and short term balance (at the level of the activity of the subsidization and financial activity) calculated through the circulating patrimonial fund.

C. The analysis of the financial equilibrium by help of the activity indicators

The financial balance can also be approached dynamically through the entity's capacity of controlling the circulating capital and its basic commercial activities which will be reflected later in cash fluxes of incoming and out coming.

For this reason activity indicators are calculated which have as a base the utility of rates rotation of the resources controlled by the entity. According to OMFP 1752/2005 the activity indicators offer information which concern:

- the incoming and out coming speed of the cash fluxes of the juridical person;
- the capacity's firm to control the working capital and its basic commercial activities.

A form of the activity indicators is represented, according to IFRS by the indicators of operational efficiency which have as scope the analysis of the measures in which an entity uses most efficiently the actives and the own capital with the help of the rotation speed of the actives and own capital.

The activity indicators have as a basis the calculation of the rotation speed and they can identify as such:

1. **The rotation speed of the actives**, both totally and separately, taking each of the actives of the components;
2. **The rotation for the debts both totally and separately**, taking each of the components of the actives;
3. **The rotation speed of the own equity.**

In each of these cases the rotation speed of the elements of the financial position (actives/debts/personal capitals) can be expressed this way:

► As a rotation number (K_{PFI}):

$$K_{PFI} = \frac{CAN}{PFI} \quad (10)$$

This way the rotation speed shows the number of rotation that the respective element make in order to obtain a certain level of business rate rotation, where:

- K_{PFI} represents the speed of the rotation "i" element of the financial position expressed by the number of the rotation;
- PFI represents the "i" element of financial position taken into consideration;

- CAN represents the turnover level of that period ;

► **As a rotation duration measured by days (Dz_{PFI}):**

$$Dz_{PFI} = \frac{PFI}{CAN} \times 365 \quad (11)$$

Expressed like this, the rotation speed shows the theoretical duration (measured by days) of replacing the whole element and respectively the financial position in the business rate

At the level of activity indicators, expressed with the help of the rotation speed of active debts, capitals correlation can be stressed in order to assure the balance such as:

1. **The obligation/claims correlation**, realized through the rotation speed of the claims which must be superior as compared to the speed rotation of the debts.
2. **The obligation/claims correlation**, realized through the speed rotation of the commercial claims which must be superior to the speed rotation of commercial debts.
3. **In dynamics, the rotation speed of active elements both taken as a whole and taken, separately must raise** from one period of time to another which reflects their fast transformation in liquidities and so we can say they are more lately administrated.
4. **In dynamics ,the rotation speed of the elements of debts both totally and taken separately must be lower and lower from** one period to another if we negotiated for farther payment terms of these.

D.The analysis of the financial equilibrium by used Cash Flow Statement

The best method to evaluate the success with a business is when the enterprise generates a number of cash inflow that are bigger than cash outflow.

The analyses of the cash is a necessity for the financial management because these are many situation when an **entity generates profit but is not solvable because of the lack of liquidities because of the discrepation between the cashings and the payments that are made.**

According to IAS 7 "The situation of the cash fluxes" through the generic term cash or treasury we mean the capacity of cash to grow or to fall and the equal quantities of cash that develop during a financial exercise. According to the same document, the cash consist of all the money dependencies and money deposits. The cash are short term financial investments that are extremely liquids and that are easily convertible in suns that are known as cash and pass through an unsatisfactory risk of changing the value.

In Romania, according to O.M.F.P. nr. 1752/2005 the "situation of the each fluxes" becomes a necessarily document to the written among the financial rapports for big entities while for other categories of entities , the writing of the document in compulsory.

In a synthetic manner, the main components of the flux of cash are represented in the following scheme:

Cash Inflows	Cash Outflows
A. Cash flow from operating activities: ΔTr (operating activity)	
<ul style="list-style-type: none"> ▶ Cash sales ▶ Receivable collections 	<ul style="list-style-type: none"> ▶ Payment for the providers of goods and services; ▶ Payments for the employees ▶ If and only if they cannot be identified with the financing and investing activities.
B. Cash flow from investing activities: ΔTr (investing activity)	
<ul style="list-style-type: none"> ▶ Cashing payment obtained out of buildings, equipment, long term activities, cashing obtained out of selling the personal capital instruments and claims for other enterprises. 	<ul style="list-style-type: none"> ▶ Payment for the acquisition of fixed means, long term actives; ▶ Payment for the acquisition of personal capital and claims for other enterprises; ▶ Payment in advance and borrowings;
C. Cash flow from the financing activities: ΔTr (financing activity)	
<ul style="list-style-type: none"> ▶ Cashing payment for the emission of actions and other instruments of own equity; ▶ Sale of marketable securities ▶ Outcomings from the emissions of obligations credits and other borrowings; 	<ul style="list-style-type: none"> ▶ Dividend payment; ▶ Interest payment; ▶ Loan repayment; ▶ Payment in order to reduce the obligations that are related to an operation of financial leasing; ▶ Purchase of marketable securities
D. Cashing flows- as a whole $\Delta Tr = A+B+C = \Delta Tr = Tr1 - Tr0$	
Cashing at the beginning of the period(Tr1)	
Cashing at the end of the period (Tr0)	

The monetary equilibrium as a whole and taken separately on each of the three activities is emphasized in this way:

$$\Delta Tr = \Delta Tr (\text{operational activity}) + \Delta Tr (\text{investing activity}) + \Delta Tr (\text{financing activity}) \quad (12)$$

And:

$$\Delta Tr \begin{cases} > 0, \text{ excedent of treasury from total activity} \\ = 0, \text{ equilibrium of treasury from total activity} \\ < 0, \text{ deficit of treasury from total activity} \end{cases}$$

$$\Delta \text{Tr (operating activity)} \left\{ \begin{array}{l} > 0, \text{ excedent of treasury from operating activity} \\ = 0, \text{ equilibrium of treasury from operating activity} \\ < 0, \text{ deficit of treasury from operating activity} \end{array} \right.$$

$$\Delta \text{Tr (investing activity)} \left\{ \begin{array}{l} > 0, \text{ excedent of treasury from investing activity} \\ = 0, \text{ equilibrium of treasury from investing activity} \\ < 0, \text{ deficit of treasury from investing activity} \end{array} \right.$$

$$\Delta \text{Tr (financing activity)} \left\{ \begin{array}{l} > 0, \text{ excedent of treasury from financing activity} \\ = 0, \text{ equilibrium of treasury from financing activity} \\ < 0, \text{ deficit of treasury from financing activity} \end{array} \right.$$

The way the financial monetary equilibrium is realized as a whole and taken separately, has direct consequences on the following **objectives**:

❖ The examination of cash flow of exploiting in order to determinate **weather these are positive and to establish the difference between the result of the exploiting and the fluxes obtained from exploiting**;

❖ The buying of cash flow from current exploiting activities with dividends from the financial activity section in order to **establish weather this out comings of financial means are justified and do not represent a special effort for the enterprise**;

❖ Of a great importance from the point of view of the information is the examination of the activity of investment in order to see **weather the enterprise expands or does not expand its activity** and which sides are to be extended or restricted;

❖ On a basis of the investments activity is examined the section referring to financing in order to analyze **the way in which the enterprise finances the expansion and if this does not expand, the way in which can reduce the debts that are apply to financing**.

At the appearance of the lack balance phenomena, the financial manager must adopt decisions of regulation, of action, on the incomes and outcomes of funds to eliminate the lack balance factors, the departure from the balance.

Between the most important ways of assuring the financial equilibrium, we mention:

- ✓ The expanding of an efficient activity;
- ✓ The rhythmical accomplishment and on the move of the requirement of the supplying, production and trading goods;
- ✓ The accomplishment of covering incomes and the obtain of good financial results;
- ✓ The finding of financial supplementary resources when the usage are to big then to existent resources;
- ✓ The reduction of the unnecessary, unnecessary and inopportune expenditures and payments;
- ✓ The cleaning of the excess stocks and the prevention of it's appearance;
- ✓ The acceleration of the rotation speed of the moving assets;

- ✓ The rational usage of the production capacity and the work force;
- ✓ The synchronization of the incomes with the outcomes of funds;
- ✓ The improvement of the cooperation between the compartments of the enterprises.

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