

ANALYSIS MODEL OF COMPANY TREASURY IN THE EUROPEAN THEORY AND PRACTICE

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Abstract: The paper approaches the financial analysis starting from the tenet that the treasury analysis represents the pivot of financial analysis, suggesting in this way the multiple aspects of this analysis for the corporate assessment.

In this regard, some cash-flow approaches are presented which can signify different analysis models of corporate cash-flows. The author presents some models reflected in the French financial theory.

Key words: corporate treasury, cash-flow; French theory.

French financial accounting is strongly marked by the concept of ownership. As a consequence, its main compulsory output has for a long time been the balance sheet. About two decades ago, however, proposals started to emerge to include a statement of changes in financial position (or a funds statement) as well in order to improve the accounting presentation of a business operation and its policies. Organizations such as banks, the associations of professional accountants and even the French accounting standard setters designed models of such statements which were discussed in numerous papers and monographs. Due to the work of professional accountants and financial analysts, as well as professors of accounting and finance, a debate arose out of these deliberations focusing on what is termed 'cash-flow accounting' in English-speaking countries. The French debate reflects this prior linkage rooted, as it was, in previous work on statements of sources and uses of funds.

Interest in the area was initiated in the late 1950s and early 1960s when a few banks and some French companies started to use funds statements, following the example of American firms. The statement only became more officially recognized in 1968, however, when a study group of the Ordre des Experts Comptables et Comptables Agrées (OECCA), the French legal association of accountants, proposed a model for the funds statement and recommended that it be presented in addition to the balance sheet and income statement. That recommendation became quite an influential one and French companies which included such a statement in their annual reports very often used it as a reference.

Another well-known model has been designed by the 'Centrale des Bilans' of the Bank of France, a statistical agency that utilized the model for its own statistical purposes. Proposed in 1975, the model was aimed at facilitating the analyses of corporate performances and policies by banks. Although this model had not been commonly used for either internal management or external reporting purposes, it nevertheless served as a reference point for the articulation of the optional model included in the 1982 Plan Comptable. In 1987, the Bank of France issued two new statements inspired by the French evolution of the last decade.

While emerging amid pragmatic influences, the concept of the funds statement has evolved since 1977 on the basis of proposals made by a number of professionals and academics. In the process, the concept was changed to become more of a form of cash-flow accounting. There is no doubt that the work of de Murard, a practitioner, played an important role in this transformation, given both his charismatic personality and the attention which the work attracted. In subsequent years, the ideas of a number of finance academics were also to be influential, no doubt reflecting the fact that initially cash-flow accounting had been regarded as an aspect of finance. It only became an accounting topic with the implementation of the 'new' Plan in 1984.

Although in the next section consideration is given to the conceptual and methodological characteristics of the various proposals, thereafter it is important to return to a discussion of the different rationales lying behind the various proposals. For already it should be evident that different emphases have emerged from different institutional contexts. While both the banker and the financial executive might incorporate social and economic, as well as financial concerns in their proposals, their interpretation of such environmental contingencies might be very different.

Only the most typical funds statements will be described in the following discussions. Although an attempt is made to avoid being too technical, the main features of each statement nevertheless need to be presented, not least because some of them are specific to the French context.

Designed to describe how the resources a company had at its disposal during the period under review have enabled it to meet its financial needs, the first part of the statement lists the uses of funds and the sources from which these were obtained. The resultant change in working capital is then analyzed in the next part of the statement which lists changes in all the individual working capital accounts.

The reporting format, although widely used by both large and small firms (the statement used by the Centres Agrées was of the same type), started to become obsolete for the purpose of financial analysis. It was proposed at a time when the concept of working capital and the distinction between short-term and long-term were important components of an analysis of the financial equilibrium of a firm. Additionally, the statement is closely related to the opening and closing balance sheets, its aim being to explain changes between the two.

The concept of 'working capital needs' (besoins en fonds de roulement) started to be articulated in 1970 and has been quite influential thereafter, allowing the analyst no longer to reason in terms of short- and long-term but rather to focus on the level of working capital in relation to factors influencing the need for it. Although the concept of need takes a normative form in planning, under this approach it enables a descriptive analysis of financial reports.

The idea was developed by three bankers, Meunier, de Barolet and Boulmer, and its success certainly reflected the particularities of the French context. The reasoning behind the concept takes the following form. At any given time, a firm must not only finance its inventories but it must also consider the credit it grants to its customers or clients, credit which can be particularly significant in France where it is customary to grant sixty or ninety days' credit. Of course, the firm itself is also a recipient of credit, the extent and conditions of which are negotiated with its suppliers. Taking account of both sides of the financial equation, a 'need' emerges which can, in some cases, be negative. In so far as inventories, accounts receivable and accounts payable are constantly renewed in a continuing activity, such needs are permanent and, according to conventional financial principles, must be financed by stable resources, i.e. be what is defined as working capital. The idea formulated by Meunier, de Barolet and Boulmer in order to facilitate the assessment of the financial equilibrium of a firm is expressed in the following equation which gives the 'cash situation', including short-term bank credits which are another peculiarity of the French system:

$$\text{Cash situation} = \text{working capital} - \text{working capital needs}$$

$$\text{With: cash situation} = \text{cash less short-term bank credit}$$

While the above equation is established either on the descriptive basis of the balance sheet or the normative basis of the financial plan, the equivalent concept applicable to the funds statement is as follows:

$$\text{Change in cash situation} = \text{Change in working capital} + \text{Change in working capital needs}$$

The concepts behind the latter equation subsequently had a marked influence on thinking about and models of funds statements. For, although the appearance might still be one of technical calculation, the approach is significant since it represents an attempt to interrogate and formulate accounting formats in terms of their subsequent analytical functions rather than in terms of their compatibility with traditional accounting statements. In this way, research was starting to provide a different basis for appreciating and changing the domain of accounting practice.

Conceptually the regulatory proposal is not as rich as the Bank of France matrix. Nevertheless it is an important step that the official text for French accountants now provides a model for the funds statement, not least because the transformation of this statement from being only a financial concern to being also one for accounting can only serve to improve French financial reporting. The structure of the proposal embodied in the Plan represents a compromise between the OECCA document and the now conventional French financial analysis equation articulated by Meunier *et al.*

$$\text{Change in working capital} = \text{Change in working capital needs} + \text{Change in cash situation}$$

Moreover, in its entirety, the model analyses two types of changes in working capital needs: those related to changes in business operations and those related to the non-operating changes.

Compared with previous approaches, that of Murard is a major conceptual and methodological change. It represents the completion of the evolution from a funds statement to cash-flow accounting. The structure of

the proposal can be summarized in three parts. As can be seen from Table 1, the first part begins with a synthesis of the income statement which results in earnings before depreciation, interest and income tax, a figure which is also found in the Centrale des Bilans statement but not in the model of the Plan Comptable. Murard, who is a practitioner, then considers a sequence of dispositions or allocations which give a series of different types of results or surpluses. For instance, in the first part of the structure given in Table 1, the first disposition that Murard considers is the financing of working capital needs. An operating cash flow then remains, from which the financing of fixed assets is deducted giving a notion of surplus E (or 'economic'). It provides a measure of the ability of the firm to respond to the financial needs which come from its current operations as well as its capital expenditure programme.

The second part of the statement is independent of the first. It provides a measure of a specifically financial surplus (surplus F) which is seen as the difference between the change in total debt, on the one hand, and outflows related to debts, i.e. interest expenses and other necessary payments (income tax and dividends), on the other hand.

Table 1 1 The de Murard analysis

PART I	
-	Earnings before depreciation, interest and income tax Changes in working capital needs
=	Operating cash flow
-	Expenditures on fixed assets
=	Operating surplus (or 'economic' surplus) (E)
PART II	
-	Issuance of long-term debts less reduction of these debts Interest expense Income tax Cash dividends
=	Financial surplus (F)
PART III	
+	Operating surplus Financial surplus
=	Current surplus (or global surplus) (G)
+ ±	Disposal of fixed assets Issuance of additional capital stock Extraordinary items
=	Change in cash

Other flows are presented in the third part of the statement which begins by the addition of surpluses E and F to arrive at a global figure, surplus G. Other changes in cash flows are then acknowledged, resulting in the overall change in cash.

From a methodological point of view, two main differences from the other statements are apparent. First, it totally ignores the notion of working capital which was a traditional basis for statements of changes in financial position. Second, it considers a more global notion of capital expenditure since the surplus E is calculated after considering not only the acquisition of fixed assets but also changes in working capital needs. The structure proposed for the statement therefore reflects a very particular mode of analysing the financial policy of the firm. Not surprisingly, the statement has been widely commented upon. Academics, in particular, have discussed the particular structure, the proposed analysis of dispositions and the related surpluses, and have presented alternative models that are perceived to be more neutral. A consideration of one of these follows.

Charreaux's analysis, which was inspired by the previous work of Levasseur and Poncet and Portait, is based on six steps which enable an analysis of different aspects of a firm's policy. These steps are related to:

- industrial operations (surplus A)

- operations related to investments (surplus B)
- changes in cash (surplus C)
- operations related to equity (surplus D)
- long-term debts (surplus F)
- short-term debts (surplus G).

A further surplus, surplus E, is also included to represent the cost savings on interest expenses, a tax effect. Some elements of the preceding analysis are to be found in the Charreaux statement, particularly the notions of earnings before depreciation interest and income tax, and operating cash flow. However, according to the author, the main originality of the proposal compared with that of Murard is that there are no specific dispositions or allocations: resources are not supposed to cover particular uses in a more or less arbitrary manner. As such, it differs from statements emanating from a more practical context, its coherence reflecting financial theory rather than practice (table 2).

Table 2 The Charreaux proposal, 1984

FIRST PART: REAL FLOWS	
Earnings before depreciation, interest and income tax (EBDIT)	
Changes in working capital needs	
OPERATING CASH FLOW	
Theoretical calculation of taxes (no debt hypothesis)	
A = INDUSTRIAL FLOW	
+ Transactions on investments	
- Interest and dividends received	
B = INVESTMENT FLOW	
C = CHANGES IN CASH	
SECOND PART: FINANCIAL FLOWS	
_ Issuance of additional capital	
stock Payment of dividends	
D = FLOW ON EQUITY	
E = COST SAVINGS ON INTEREST EXPENSES	
Change in long-term debt	
Interest expense on short-term debt	
F = FLOW ON LONG-TERM DEBT	
Change in short-term financial debt	
Interest expense on short-term debt	
G = FLOW ON SHORT-TERM DEBT	
NB: A+B+C=D+E+F+G (Total real flows = Total financial flows)	

If the Bank of France uses both statements in its financial studies of French firms, the public accountants (the OECCA) also issued two statements in 1988 but recommended a cash-flow format (Table 3).

The first, a funds statement, is quite close to the document of the 'plan comptable' although presented in a different manner. It is not developed here.

As to the second, a cash-flow statement, the application is obvious: it is strongly inspired by SFAS n° 95 from which it borrows the general structure:

Cash-flow from operating activities + Cash-flow from investing activities + Cash-flow from financing activities = Increase (or decrease) in cash + Cash at beginning of period = Cash at end of period

Table 3 The OECCA cash-flow statement, 1988

(A) NET CASH FLOW FROM OPERATING ACTIVITIES

* Net income

* Elements without effects on cash or not related to operations (depreciation, amortization, gains or losses on disposals of assets, etc.)

* Changes in inventories, clients, suppliers and other items related to operations (change in operating working capital needs)

(B) NET CASH FLOW FROM INVESTING ACTIVITIES

* Acquisition and disposal of fixed assets

* Transactions on investments

* Changes in accounts related to investing activities

(C) NET CASH FLOW FROM FINANCING ACTIVITIES

* Changes in capital stock

* Dividends paid

* Issuance and reduction of debt

CASH * Effects of exchange rates changes (D)

* Opening cash (E)

* Closing cash = (A) + (B) + (C) + (D) + (E)

It is noticeable that the conceptual content of the statement is not in line with some definitions of the Accounting Plan. The two main differences bear on the definition of cash (larger in the US and OECCA texts than in the PCG) and on the concept of operating activities (larger than in the PCG). The promoters of the document have clearly preferred the international (i.e. US) framework rather than consistency with the French tradition. This is altogether a testimony to the influence of international standards and a mark of independence of the French profession. If the Conseil National de la Comptabilite is still 'the' official French accounting standard setter, other bodies such as the OECCA have from time to time the willingness to assert their autonomy.

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