THE EFFICIENCY OF FOREIGN INVESTMENTS IN THE FINANCING OF AUDITED ENTITIES

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Abstract: *The auditing of the financial statements is a certification service intended to offer the users more credibility regarding the quality of accounting information. This is the reason why the present study selected all the Cluj county entities that, according to the public information, between 2005-2012 were subject to financial audit in order to estimate, at this level, the influence of foreign investments in the financing structure. The information provided by the financial statements of these audited entities (with or without foreign participation in share capital) was analyzed for the calculation of the relevant indicators to determine the evolution of the equity financing, the recourse to external financing funds, the ratio of external funds and equity funds used for financing and the assessment of the efficiency of foreign capital invested at the level of these entities. In order to meet this objective, we considered the information from the financial statements of the concerned entities, published between 2008-2011. For the relevance of the study, we eliminated the audited entities that did not have financial statements published in all of the four financial years for various reasons (dissolution, liquidation, merger, or temporary suspension of activity) or had negative working capital. The financial statement information was analyzed in view of the calculation for each audited entity of the rate of financial autonomy, the debt ratio, the debt to equity ratio and of the rotation speed of equity. The audited entities were classified into 2 major categories: audited entities with a foreign participation in share capital and audited entities with the whole share capital financed by equity funds. We applied the simple average method at the level of the both audited entities categories for each of the four analyzed indicators. Furthermore, we performed an analysis from the static and dynamic point of view of the results. The conclusions that we reached are relevant for the emphasis of one of the two categories of audited entities for one or the other financing methods, for a specific proportion of the financing forms and for the assessment of the management of shareholders' capital in the analyzed time span.*

Keywords: audited entities; financial statement; foreign investments; equity funds.

JEL classification: M41, M42

1. Introduction and Literature Review

The financial statements of the audited entities offer the users more credibility. The auditors play an important part in offering a guarantee in what concerns the reliability and accuracy of the information in the financial statements of the audited companies. (Boţa-Avram, 2012) The financial audit is in fact a certification service that results in a report in which the auditor expresses an opinion concerning the compliance of the significant aspects of the financial statements with the general accepted principles of accounting (Loebbecke, 2010). Financial auditing brings many benefits, among which we mention, considering the relevance for the present study, the following: the increase of trust of the users in the accounting information Ghiţă, 2008), the increase of trust in the company, the detection and prevention of significant alteration of information in the financial statements (Oprean, 2007). There are also reviews in the literature according to which the auditor's role in society is that of validating the truth and fairness of the financial statements (Dart, 2011). Therefore, the activity performed by auditors is placed by investors in a special position of public trust (Martens and McEnroe, 1992). Another clue as to enhance confidence in the activity performed by auditors is the process by which auditors has selected, retained and compensated. In addition, the literature accomplishes two goals: identification of the problem of audit independence as an outcome of vesting the authority to make an auditor-related decisions with corporate boards of directors, and proposing a structure to allow shareholders to direct path for deciding on choice and auditor compensation (Rashad, 2002). Therefore, in order to accomplish this study were selected only the audited entities because their financial statements indicate a high level of credibility, based on these considerations.

2. Research Methodology

The entities that between 2005-2012 were subject to statutory audit according to the provisions of the OMFP 3055/2009 represent the basis of the present study. According to these provisions, the audit of the financial statements is mandatory in the case of entities that at the drafting date exceed the limits of two of the three following size criteria:

-total assets 3.650.000 Euro;
-net turnover 7.300.000 Euro;
-average number of employees during the financial year 50.

We took into account in an exhaustive manner all the audited entities during this period across the Cluj county (304 entities). We analyzed information regarding these entities for the financial years 2008-2011 in what concerns:

-the incidence of foreign investments on the financial status
-the level and evolution of assets, of equity funds, of debts and turnover;
-the level of financial dependence and management of the controlled resources

In order to meet the objective of this study and to guarantee the relevance of the results, we eliminated from the study 102 audited entities that did not publish between 2008-2011 any information through the financial statements. This was due to the changes that appeared in the structure of the social capital and/or the activities (mergers, dissolutions, liquidations, insolvencies, temporary suspension of activity). Also, 29 other entities were not taken into consideration due to their negative values of their equity funds. Consequently, out to the total 304 entities that were subject to the statutory audit across Cluj county between 2005-2012, we included 173 audited entities in our research. Therefore, our study is exhaustive in what concerns all the entities audited in this period in the Cluj county and that published in all the 4 years (2008-2011) their financial statements and had positive values of their equity funds. In view of the analysis of the evolution in the temporary interval of 4 years of the relation between foreign investments in the audited entities on one hand and the financial dependence rate, namely the management of the controlled resources on the other hand, we used some indicators relevant in this respect:

-Rate of financial autonomy (R_{FA}) to emphasize the evolution of the financing of the audited entities activity from equity funds (Bătrâncea, 2008);

-Debt ratio (D_R) in order to see how the audited entities' assets are financed on the basis of debts to third parties;

-Debt to Equity Ratio (D_{ER}) to emphasize to what extent the resources of audited entities resources were purchased with foreign capital;

-Rotation speed of equity (R_{SE}) to show management efficiency in what concerns the shareholders' capital in the analyzed time span (Greuning, 2005).

The above-mentioned indicators were calculated for each audited entity. These were divided into two categories: entities with foreign participation in share capital and entities without foreign participation in share capital. In view of the interpretation of the results, we applied the simple average method on the values of the indicators in each of the two categories, according to the involvement/non-involvement of foreign investments.

3. Results and Discussions

Out of the 173 entities audited in the present study (positive value of equity funds and published financial statements for the financial years 2008-2011), 26 had foreign participation in share capital (foreign investments), and 147 audited entities didn't have foreign participation in share capital.

In the beginning, the study analyzed the extent to which the audited entities finance their activity out of equity funds, showed by the rate of financial autonomy(R_{FA}). From a dynamic standpoint, the increase of this value is highly appreciated, and the financial security interval is [30%, 100%] (Achim, 2009). The results of the study show the following evolution on the long term of the rate of financial autonomy for the two categories of audited entities:

Table 1: The evolution of the rate of financial autonomy for the audited entities in relation with the foreign participation in share capital

Foreign participation in share capital	**Rate of Financial Autonomy (RFA)**			
	RFA2008 -%-	**RFA2009 -%-**	**RFA2010 -%-**	**RF2011 -%-**
YES	54	53.5	55	58
NO	63	64.5	60	59

Source: Statistical processing performed by the authors

We notice that both categories of audited entities are situated inside the safety interval, almost in its center. This shows that the audited entities finance their activity mainly from equity funds (Self-financing). During the economic-financial crisis, the audited entities were not confronted with difficulties in facing the payment necessities and attracting external financing resources would not be mandatory.

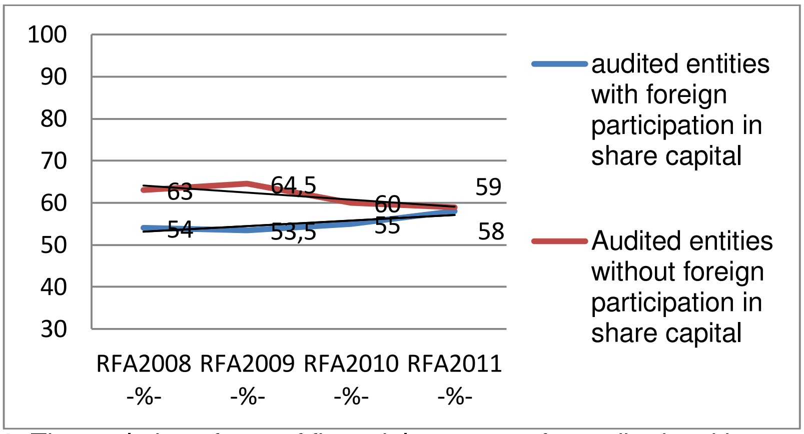

Figure 1: The evolution of rate of financial autonomy for audited entities
Source: Statistical processing performed by the authors

Taking into account the dynamic aspects regarding the evolution of the rate of financial autonomy, according to figure 1, we can notice that the audited entities without foreign participation in share capital show values superior than the other category of entities, which means that these tend to finance their activity especially of equity funds (increase of share capital, undistributed profit) and recourse less to external financing sources in comparison to the audited entities with foreign participation in share capital. The opposite trends set by the two categories of entities are worth mentioning. The audited entities without foreign participation show a decrease in the preference for the financing from equity funds (drawback), whereas the audited entities with foreign participation in share capital tend to choose the financing mainly from equity funds (Advantage). Regardless of the financing options, at the 2011 level the percentages of the financing options are the same. In the case of both types of audited entities, these tend towards the percentage of 58-59%, namely at the middle of the safety interval (reach the optimal value). The stabilization of the rate of financial autonomy for the audited entities from Cluj county at the optimal value at the 2011 level means adequate contribution of equity funds to the development of activity and the convergence of corporate governance politics towards an external adequate indebtedness (even optimal). Moreover, we studied the evolution of the (Debt Ratio) (RPF_A) to show the extent to which the assets of the entity are financed by the total indebtedness (on the short and long term). In the specialized literature, the opinions tend to show a preference for an ascending trend and the maintenance of the indicator in the safety level [0%, 30%].

Table 2: Debt Ratio evolution for the audited entities - the foreign participation

Foreign participation in share capital	Debt Ratio (DR)			
	DR2008 -%-	DR2009 -%-	DR2010 -%-	DR2011 -%-
YES	46	46.5	45	42
NO	37	35.5	40	41

Source: Statistical processing performed by the authors

Both categories of audited entities show values that slightly exceed the limit of the safety interval, thus the assets are excessively financed on the basis of long and short term debts towards third parties. This aspect can be considered to be unfavorable if we refer only to the extent to which this indicator for audited entities complies or not with the limit of the safety interval. However, it we analyze the debt ratio evolution from a dynamic point of view during the financial years 2008-2011 we obtain the following information according to figure 2:

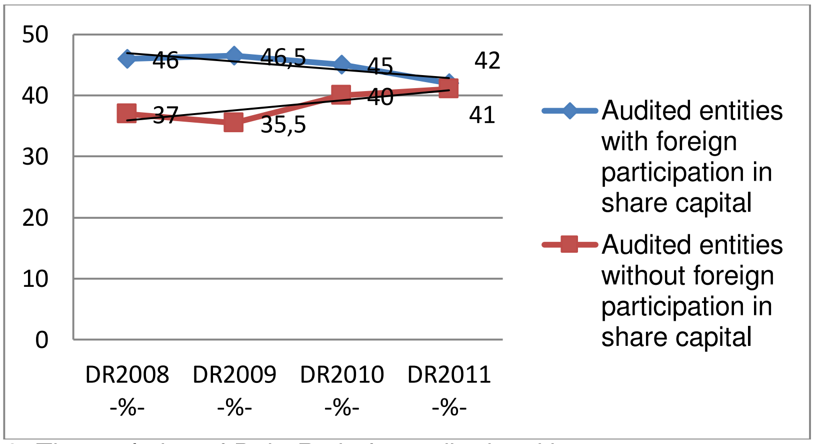

Figure 2: The evolution of Debt Ratio for audited entities
Source: Statistical processing performed by the authors

The audited entities with foreign participation in share capital show an ascending trend during the four financial years and had a decrease of 8.7%. Therefore we noticed the trend of decreasing the excessive financing on the basis of third parties debts (advantage) and consequently the increase of the financing based on equity funds. In the case of audited entities without foreign participation in share capital, we noticed an opposite trend (unfavorable evolution). Although the percentage of financing on the basis of third parties debts is situated over the safety limit, we noticed and ascending trend between 2008-2011 in what concerns the preference for the insurance of the financing from this source (10.81% increase). In what concerns the evaluation of the type of financing of the audited entities activity it is important to determine the extent to which the economic resources of the company are procured from foreign capital. In the case of the debt to equity ratio (DER) we consider that a descending evolution of the indicator is favorable. The upper accepted limit considered to be reasonable in the case of this indicator is 200%. The total amount of debt must be twice bigger than the value of equity funds of the entity so that it will not affect the capacity to support long term debt. The debt to equity ratio for the audited entities show between 2008-2011 values that exceed the maximum acceptable limit that guaranteed security in what concerns the reimbursement capacity of long term debts.

Table 3: Debt to Equity Ratio Evolution for the audited entities in relation with the foreign participation in share capital

Foreign participation in share capital	**Debt to Equity Ratio (DER)**			
	DER2008 -%-	**DER2009 -%-**	**DER2010 -%-**	**DER2011 -%-**
YES	251	217	214.5	228
NO	266	163.5	783.5	923.5

Source: Statistical processing performed by the authors

Even though the audited entities with foreign participation in share capital show indicator values that exceed the maximum safety limit, these can be considered minor (an average of 13.81%). This is an oversized value of the third parties debts (external resources) as compared to the debts towards shareholders (internal resources). Whereas in the case of this audited entities categories we can say that the exceeding of the safety limit is reasonable, we cannot say the same thing on the audited entities without foreign participation in the share capital. In this case, the exceeding of the maximum acceptable limit, during the four financial years is an average of 167.06%. At the level of all audited entities in Cluj county that published financial statements between 2008-2011 and had positive equity funds, the shareholders are not very involved from a financial point of view in the progress of activities; they avoid assuming risks deriving from the equity funds investments and they prefer the alternative of attracting external resources for financing. To have a complete overview on these aspects we need to present the evolution on the long term of the debt to equity ratio, according to figure 3:

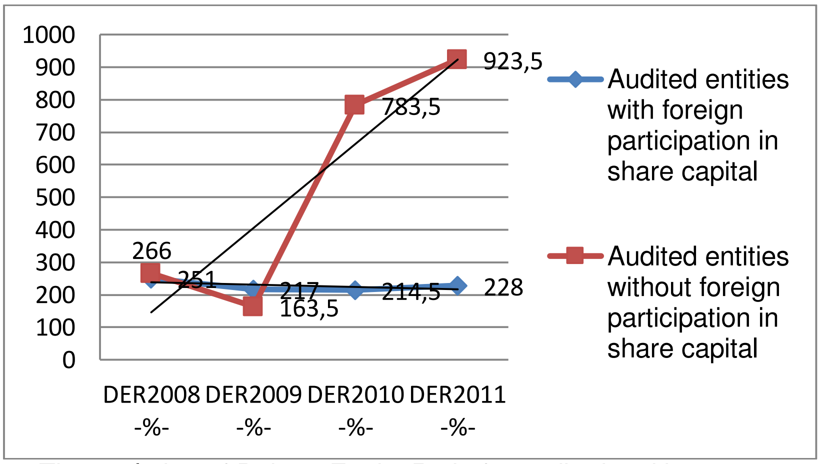

Figure 3: The evolution of Debt to Equity Ratio for audited entities
Source: Statistical processing performed by the authors

Although they only slightly exceeded the maximum value acceptable for the debt to equity ratio (unfavorable aspect), the audited entities with foreign participation in share capital show a descending evolution trend of this indicator (favorable aspect). Consequently, we noticed an increase in the funding of business out of equity funds, rather than external financing (Bank credits, commercial credits).
We cannot say the same thing regarding the audited entities without foreign participation in share capital, where the debt to equity ratio tends towards an exponential ascending trend (unfavorable aspect).
Consequently, the equity financing of shareholders decreases and the long term debt financing increases, through financial, commercial, fiscal and wage debt.
The risk represents the decreased capacity of the audited entities from this category to support long term debt. The efficiency of using the shareholder's capital (the number of rotations performed) to obtain a certain turnover is measured with the rotation speed of equity indicator. An increase in the rotation speed of equity reveals an increase of the management efficiency in the administration of shareholders' capitals.

Table 4: Rotation Speed of Equity evolution for the audited entities in relation with the foreign participation in share capital

Foreign participation in share capital	**Rotation Speed of Equity (RSE)**			
	RSE2008 -%-	**RSE2009 -%-**	**RSE2010 -%-**	**RSE2011 -%-**
YES	7.5	5	6.5	4.5
NO	2	2	2	6

Source: Statistical processing performed by the authors

The audited entities with foreign participation in share capital show superior efficiency levels in what concerns the use of shareholders capitals, as compared to audited entities without foreign participation in share capital. Apparently, the foreign investment involvement entails the high efficiency of the activity.
To have a complete overview on the capital use efficiency it is important to perform a dynamic analysis of the rotation speed of equity for the financial years 2008-2011, according to figure 4.
Although high values of the indicator were registered and consequently a high efficiency, the audited entities with foreign participation in share capital points out a decrease on the long term of this level of performance, the trend is a descending one.
In the financial year 2011, the rotation speed of equity shows a decrease in relative sizes as compared to the financial year 2008 with 40%, the efficiency level became inferior to the audited entities without foreign participation in share capital.

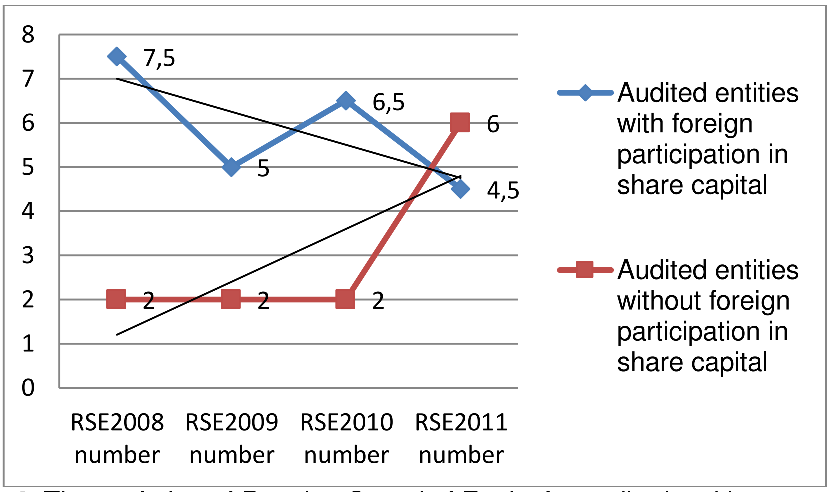

Figure 4: The evolution of Rotation Speed of Equity for audited entities
Source: Statistical processing performed by the authors

On the other hand, the latter ones show an ascending trend of the evolution of management efficiency in the administration of shareholders' capital, the level of the rotation speed of equity indicator showing increases in the analyzed time span with 200%.
These entities reach the 2011 year level to be more efficient as compared to the audited entities with foreign participation in share capital.
We consider useful for getting an overview and some relevant information on the results of the research, the centralization of information presented above. Therefore, it can be achieved the following synthesis on the results of the study, which includes the analyzed aspects as well as the results obtained for the two categories of audited entities, as it results from table no. 5:

Table 5: Financing sources and the shareholders' capitals use efficiency for the audited entities

Analyzed aspects for 2008-2011 for audited entities during 2005-2012	**Audited entities typology**							
	Audited entities with foreign participation in share capital				**Audited entities without foreign participation in share capital**			
	Static		**Dynamic**		**Static**		**Dynamic**	
	Medium level achieved	Optimal level	Achieved trend	Optimal trend	Medium level achieved	Optimal level	Achieved trend	Optimal trend
Equity financing	55%	[30%, 100%]	Asc	Asc	62%	[30%, 100%]	Desc	Asc
External resources involved in financing	45%	[0%, 30%]	Desc	Desc	38%	[0%, 30%]	Asc	Desc
Extent-resources procured from foreign capital	228%	<200%	Desc	Desc	534%	<200%	Asc	Desc
Efficiency of invested capitals used	5.9	-	Desc	Asc	3	-	Asc	Asc

Source: Statistical processing performed by the authors

As shown in the previous table, the audited entities with foreign participation in the share capital or those which have the share capital of local origin, achieve different levels of performance concerning the indicators taken into consideration.

4. Conclusions

The two categories of audited entities that we analyzed in the present study show different evolutions (according to the involvement of foreign investments) regarding the dynamics of the main financing type, the extent to which the audited entities resources were procured out of foreign capital or the management efficiency of the administration of shareholders' capitals.

Our study shows that audited entities with foreign participation in share capital show an adequate proportion of equity capital with a positive, ascending evolution during time.

The dependence on external resources is too high, but it is important that the trend is a descending one in this case. The slightly high but reasonable proportion between the total debt and the equity capitals show a moderate risk in what concerns the choice of external or internal financing.

The audited entities without foreign participation show a reduction of the trend of resorting to external financing, preferring equity financing. In this way, the business, as well as the external capital dependency risk is reduced.
The financial involvement degree of entity shareholders is quite high. The shareholders' own resources are more efficiently used than in the case of the other audited entities categories.
On the other hand, in the case of audited entities without foreign participation in share capital, although they finance their activities to an adequate extent from their own funds, the contribution of shareholders in the business process shows a descending, negative evolution. The dependence on external financing is quite high; moreover, it shows growing tendencies in the future.
Moreover, the percentage of these external financing is much higher than the level of financial involvement of shareholders in the management of the audited entities.
Consequently, the audited entities prefer the external resources, an increasing trend (possibly indebtedness, assuming high risks) that subsequently they do not use efficiently enough given the fact that they show rotation speeds of equity more reduced than in the case of the other categories of audited entities.
In conclusion, the most stable audited entities from the financing resources point of view and the efficiency of their use, the most stable are the audited entities with foreign participation in the capital. In the case of these, the most well funded assumption is the one of continuing the activity without any prospect of reducing it.
After analyzing some credible information, of some audited financial statements, it can be found in the Romanian entities with foreign participation in the share capital, a more effective use of shareholder's capital , given that these businesses are self-financed to a lesser extent compared to the entities which have registered exclusively local capital. The management option in the field of financing is predominantly oriented towards the effective use of external resources, with the ultimate in reducing the risk of investments through a lower implication of the shareholder's capital in financing.

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