

PROFIT AND LOSS ACCOUNT – SYNTHETIC EXPRESSION OF ABSOLUTE RETURN

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Abstract

This study has as main objective the presentation of the current state of knowledge regarding the profit and loss account as part of the financial statements which express in absolute value the profitability of companies and the empirical analysis of these concepts based on the information submitted by OMV Petrom between 2011 and 2015.

Thus, in the first part we present several approaches from the specialized literature regarding the aspects mentioned above.

The second part follows a vertical and horizontal analysis of key indicators used for measuring the absolute return. For the horizontal analysis we pursued the evolution in time of the following indicators: Gross Margin, Earnings Before Interest and Taxes (EBIT), Financial Result, Gross and Net Result. The vertical analysis aimed to explain the formation of the Gross Result via EBIT (which was also analyzed through the Gross Margin and other specific elements) and of the Financial Result (which was also analyzed through the different types of financial income and expenses).

The results of the study revealed problems of profitability in the years 2014 and 2015 which, in our opinion, can be attributed to poor management of the commercial activity, exploration activity (research and development), distribution and financial activity.

Key words: *profitability, efficiency, structure, gross result.*

JEL code: *M40, M41*

1. Introduction and context of the study

The issue of profitability analysis divides theoreticians and practitioners from the field of economic and financial affairs into two sides: those who support the principles of the analysis based on indicators in absolute measure and those who rely mainly on indicators used for assessing profitability in relative measure [12]. Even if the analysis based on the indicators for assessing profitability in relative measure have the indisputable advantage of allowing a much more easier benchmarking between entities that have common elements (comparisons in space), there are numerous studies that highlight the higher utility of the indicators in absolute measure, even in areas such as expressing the hidden volatility in the financial markets [10]. Moreover, correlations between the volatility of the financial markets and absolute return indicators are also highlighted by other authors [8].

2. Research methodology

In terms of research methods, the theoretical part of the study was achieved through expressing the opinions from the specialized literature regarding the analysis of the profit and loss account as a tool of expression of absolute return of entities.

Regarding the empirical research, the analysis was based on the financial information recorded by OMV Petrom SA between 2011-2015. This analysis aimed at presenting the absolute numbers expressing the profitability of the company in the examined period of time starting from the gross

result (as a key indicator of expressing absolute return) and moving vertically with the observation of the influence that each element has on the indicator from the top level of analysis.

3. Literature review

The profitability analysis is an area that is always of interest for theoreticians and practitioners in the financial-accounting business. As means to express performance (profitability), the main indicators are the ones found in the profit and loss account (absolute values), but, in our opinion, the capitalization of these figures is done through relative figures or by processing absolute values in order to obtain certain rates that characterize more eloquent the image on the profitability of a company. At the same time, correlating these indicators with other types of indicators, as well as observing how the latter may affect the profitability of the analyzed entities represents an aim itself of the profitability analysis [2].

Summarizing the studied aspects, we admit that when analyzing a single entity (possibly when an analysis in dynamics/time is desired), we can content ourselves to an analysis based on absolute figures, but if we aim at pursuing comparisons in space, it is necessary to use indicators of assessing profitability (performance) in relative size. This approach is validated also by Camilleri, S. J. [5].

The shortcomings of absolute measures when pursuing a comparison in space (between companies operating in the same geographical area) are highlighted also by Deaconu, S.C., [6], who considers inadequate a ranking of companies based exclusively on turnover.

In the same manner is carried out the analysis performed by Droj, L., [7] who uses only the relative size indicators for assessing performance (profitability) of entities, resorting to raw data from both the profit and loss account and the balance sheet.

The problem of using absolute or relative numbers in the analysis of return (performance) is definitely settled by Gibson, C., [9], who states that absolute values do not have so much informational power as relative figures (rates) obtained by reporting to bases such as: assets used in production, invested capital, or sales.

Returning to the profit and loss account (often met as the „Statement of revenue and expenditure”, especially in the optics of reporting according to IFRS), it includes the absolute values of profitability indicators expressed in general by income and expenditure or by indicators obtained from making the difference between income and expenses, respectively result indicators [3].

Moreover, regarding the presentation of the profit and loss account, other opinions can be found: a research study [14] shows that both finance and accounting professionals, especially investors, would prefer a form of the profit and loss account in two columns.

The character of the profit and loss account as an instrument for measuring the absolute return is emphasized also in the study published by Monea, M., [13], who conducts an analysis of the dynamics and structure of the elements contained by the profit and loss account.

Although there are specialized studies [11] which suggest the idea that the financial audit of the annual financial statements aims to present an image of the general state of the entity, in our opinion this approach is incorrect, because the role of the audit is to present the measure in which the annual financial statements are drawn up or not in accordance with the applicable reporting.

However, profitability analysis based on the profit and loss account as a way to express the performance of economic entities represents only one of the first steps of the decisional process. An example of such a complex analysis is provided by Burja, C., [1], which shows how the return (expressed in relative values this time) is influenced by various factors such as the rate of fixed assets, the degree of leverage, the financial lever, return on sales based on current assets, return on sales based on equity, etc.

Obviously, our hypothesis (that the profit and loss account offers an image of the absolute profitability of the entity) does not exclude the possibility that, based on the indicators included in the profit and loss account, to make an analysis based on relative numbers. An example of this is provided by Căruntu, C., and Lapadus, M. L., [4] who use the indicators from the profit and loss account to calculate a series of specific rates.

In order to observe the way in which the analysis of the indicators from the profit and loss account can be made, we realized an observation of OMV Petrom SA between 2011 and 2015.

4. Results and discussions

The indicators from the profit and loss account of the analyzed company are presented in Table no. 1:

Table no. 1: The indicators from the profit and loss account of OMV Petrom SA between 2011 and 2015

Indicator	Financial exercise				
	2011	2012	2013	2014	2015
Sales revenue	16183,68	19122,51	18087,52	16537,18	13952,49
Direct costs of distribution	-13,28	-21,56	-37,81	-21,32	-11,96
Cost of sales	-10012,6	-12653,5	-11554,98	-11906,1	-13473,75
Gross margin	6157,8	6447,45	6494,73	4609,76	466,78
Other operating income	374,7	144,07	245,41	246,55	411,76
Distribution expenses	-304,72	-318,02	-309,69	-348,83	-307,71
Administrative costs	-107,15	-112,79	-100,63	-128,66	-115,48
Exploration costs	-308,49	-329,53	-423,45	-153,2	-576,61
Other operating costs	-1152,32	-763,36	-574,47	-684,9	-473,92
EBIT	4659,82	5067,82	5331,9	3540,72	-595,18
Income from investments	303,22	287,11	533,74	358,45	585,49
Interest income	0	182,77	284,22	126,59	268,55
Interest costs	-278,05	-857,12	-382,91	-550,54	-400,75
Other financial income and costs	-218,64	-97,11	-99,86	-932,25	-554,94
Financial net result	-193,47	-484,35	335,19	-997,75	-101,65
Ordinary result	4466,35	4583,47	5667,09	2542,97	-696,83
Tax on income	-736,57	-732,86	-827,76	-705,82	66,19
Net result	3729,78	3850,61	4839,33	1837,15	-630,64

Source: *Annual financial statements of OMV Petrom SA*

Thus, we can see that the net result consists of two main factors of influence: gross profit and tax on income. Since the tax on income is set by the state, it is an element that can be controlled by the analyzed entity in a very small extent. In this case, we will direct the commencement of the analysis to the gross income (EBT).

Regarding the gross result, there are two major factors influencing its level: EBIT and the financial result.

$$EBT = EBIT + \text{Financial result (1)}$$

From the analysis, we can easily see that the level of EBIT is found mostly in the gross result. This highlights the importance of mining activities for the analyzed entity. Regarding the financial result, with the exception of 2013 when it was positive, we can see that this has a negative impact on EBT, the negative influence being found also in the average of the analyzed years.

The calculation formulas based on which we will continue the analysis are:

$$EBIT = \text{Gross margin} + \text{Other operating income} - \text{Distribution costs} - \text{Administrative costs} - \text{Exploration costs} - \text{Other operating costs (2)}$$

$$\text{Financial result} = \text{Income from investments} + \text{Interest income} - \text{Interest costs} \pm \text{Other financial income and costs (3)}$$

1. Structural analysis of EBIT

$$EBIT = \text{Gross margin} + \text{IANE (4)}$$

Thus, we can observe the negative influence in all the analyzed years (and implicit at the level of the annual average) of the IANE indicator on EBIT. In our opinion, there is an imbalance between the potential of the commercial activity to create value and the consumption generated by the indirect operating activity.

To observe the origin of these imbalances, we will deepen the structural analysis by studying the influence of the elements which are incorporated by IANE and gross margin.

$$\text{Gross margin} = \text{Sales revenue} - \text{Direct costs of distribution} - \text{Cost of sales (5)}$$

$$\text{IANE} = \text{Other operating income} - \text{Distribution costs} - \text{Administrative costs} - \text{Exploration costs} - \text{Other operating costs (6)}$$

1.1. Structural analysis of the gross margin

From the structural analysis of the gross margin we can observe that within it, the direct costs of distribution are almost non-existent (their size is negligible). However, the negative impact on EBT is due to the lack of power of the gross margin to cover the negative impact of the net financial result (although, in absolute value, this is also at the minimum from the period 2011-2015).

1.2. Structural analysis of IANE

This analysis highlights a relatively balanced distribution of the analyzed elements from the composition of IANE, without abrupt evolution from one year to another. However, we believe that the periods 2012-2013 and 2014-2015 are characterized by a better dynamic of the two indicators, given the tendency of increase of other operating income and the decrease in other operating expenses.

2. Structural analysis of the financial result

$$\text{Net financial result} = \text{Income from investments} + \text{Interest income} - \text{Interest costs} \pm \text{Other financial costs and income (7)}$$

The analysis highlights the year 2013 as being the only year in which the financial result is positive, something which, in our opinion, is caused mainly by the low level of the other financial income and expenses. However, it is noted that the elements of income recorded lower variations than the ones of the expenditure, which provides a higher predictability of the income elements.

5. Conclusions

The research has highlighted the profit and loss account as an element of the set of annual financial statements through which the profitability of the analyzed entities can be expressed.

We also consider that at the poor results of the years 2014 and 2015 also contributed the inadequate management of financial activities, and also the ineffectiveness of exploration and distribution expenses. This aspect highlights the limits of the analysis of return in absolute values, but also offers the opportunity for the transition to the analysis of relative return.

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