

ACCOUNTING TREATMENTS FOR FINANCING ENTITIES

CRISTINA MIHAELA NAGY,
VIOREL TRIF, BOGDAN COTLEȚ*

ABSTRACT: *One of the most important aspects of an entity is, without doubt, how to finance it, this being an ongoing concern of managers, particularly seeking the cost reduction of the borrowed capital and the increase of the financial profitability instalment. Accessing irredeemable funds is a reality of the recent years. Increasingly more companies are looking to these funds to achieve some development objectives. A thorough analysis of the financing possibilities (subsidy) is important for any entity, but the choice has to be made based on the recommendation of the domain specialists. No price is too high if it ensures you business continuity.*

KEY WORDS: *accounting policies; financing methods; Irredeemable financings*

JEL CLASSIFICATION: *M41*

1. INTRODUCTION

Year 2009 did not bring to much good news for small entrepreneurs and the bad news became a reality in Romania who faces the impact of a global economic crisis. The global economic crisis which started in 2008, also affected Romania, having negative effects on large companies and as well as on small entrepreneurs that were trying to carve a path in the economy. In the period October 2008 - March 2009, 57.58% of S.M.E's have reduced activity, 14.80% of companies went bankrupt.

According to Mediafax in 2009, 18,421 companies went bankrupt and the number of firms that entered into insolvency increased to 14,724, with 25% over the level in 2008. To remain on the market entities have to develop and to modernize the

* *Teaching Assistant, Ph.D. Student, „TIBISCUS” University of Timișoara, Romania, cristinanagy2009@yahoo.com*

Lecturer, Ph.D., „TIBISCUS” University of Timișoara, Romania, trifviorel2009@yahoo.com
Ph.D. Student, West University of Timișoara, Romania, toldo_bogdan@yahoo.com

investments in facilities, equipments, machinery, gears by purchasing technologies, patents, trademarks, licenses, and by implementing and certifying quality management and environmental systems. We must therefore appeal to all sources for obtaining capital.

2. FINANCING

Financing is the entities' option destined for obtaining funds (liquidities) in order to cover temporary needs generated by commercial or production activities, or for development the existent production capacity through unfolding investments projects. Financing decision means choosing between personal funds and external fund for an investment project, and most part of the financial resources come from private sources (commercial banks, investment banks, investment funds), public sources usually occur in financing some important investment project and of general interest.

Sources of financing business are presented in the following figure.

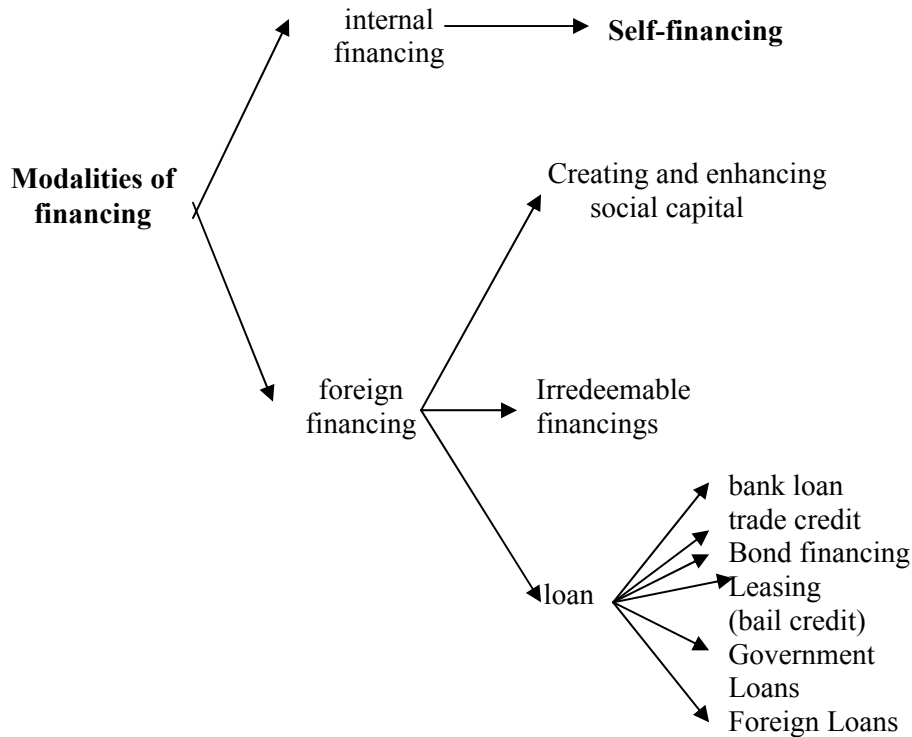


Figure 1. Sources of financing business

The main modalities of financing used by the entity are:

1. *Self-financing* - conducted by using only positive financial results achieved in previous years. It is rightly so considered as the most "healthy" way of funding and relies solely on the entity's own possibilities, having as main sources the

redemption of fixed capital and the undistributed part of the profit that is put into reserves and that is the financing source in forming capital.

2. *Resorting to long-term, medium or short-term loans*, made by issuing bonds or appealing to specialized credit institutions. Bank credit can be a very convenient way of financing, the bank offers the applicant an amount of money that will be reimbursed at a particular term, but in the context of a Romania in crisis, the financings granted by banks or non-bank financial institutions have become increasingly difficult to obtain, with high interest and bank fees.
3. *Resorting to external personal capitals* – accomplished by increasing cash capitals or by contribution of capital.

In essence, the financial systems' evolution has also determined the evolution of the financing methods for enterprises, from a self-financing system to a direct financing system (without intermediaries) and then at the intermediary financial system. As a matter of fact, these three financing methods reflect exactly the ensemble evolution of the financial system.

Starting from the moment of adhesion, Romania has access to financial resources, including Structural Funds (OP - Operational Programs are documents which set out the implementation of strategic actions in the NSRF and therefore effective access to Structural Instruments. There were developed seven operational programs (OP) in the "Convergence" Objective) which occupies a very important role. These aim at reducing disparities between European regions and promoting balanced and sustainable economic and social development.

The following fields can be financed from structural and cohesion funds of the EU and State aid: research and technological development, computerization of society, transport, energy, environment protection and risk prevention, tourism, culture, urban and rural regeneration, businesses and entrepreneurs, access to stable employment, social inclusion for disadvantaged persons, human capital development, investment in social infrastructure, including health and education and promotion of partnership development.

For a more analytic classification of the financing resources other five criteria can be used. These are:

- the nature of the debentures determined by the financial operations;
- the operations' term;
- the origin of the used funds;
- the nature of the funds' use or destination;
- reimbursement manner.

“From my point of view, the best classification is the one *regarding the reimbursement manner*. From this point of view, we distinguish two types of financial resources:

- reimbursable financial resources;
- unredeemable financial resources.” (Nagy & Trif, 2010)

Accessing unredeemable funds is a reality of the last years. More companies direct themselves towards these funds in order to accomplish the development objectives.

Reimbursable financial resources consist in the enterprises' obligatory character to repay at a certain term the loaned sum in the depreciable way in equal or unequal instalments at different terms or unredeemable, if the reimbursement of the loaned sources is made entirely at a single term. Usually, in this category of financial resources there are: bank loans, bonds, bank acceptance, commerce effects, as well as salaries and taxes and commercial credits.

A special category of public funds is the irredeemable financial aids granted by the group of developed countries or by international bodies (PHARE, Structural Funds EU grant funds provided by FAO, UNDP, and ONUDI).

Structural aids mobilized for the 2000 - 2006 period reached 213 billion Euros and they will be used to improve the economic situation of disadvantaged regions, which have specific deficits and weak social categories.

Table 1. Structural Aids 2000 – 2006

Structural Aids 2000 – 2006	213 billion
Structural Funds	195,00 billion
- Priority Objectives	182,45 billion
- Objective 1	135,90 billion
- Objective 2	22,50 billion
- Objective 3	24,05 billion
■ Community Initiatives	10,44 billion
■ The program for supporting fisheries	1,11 billion
■ Innovative support and technical assistance	1,00 billion
■ Cohesion and technical assistance Fund	18 billion

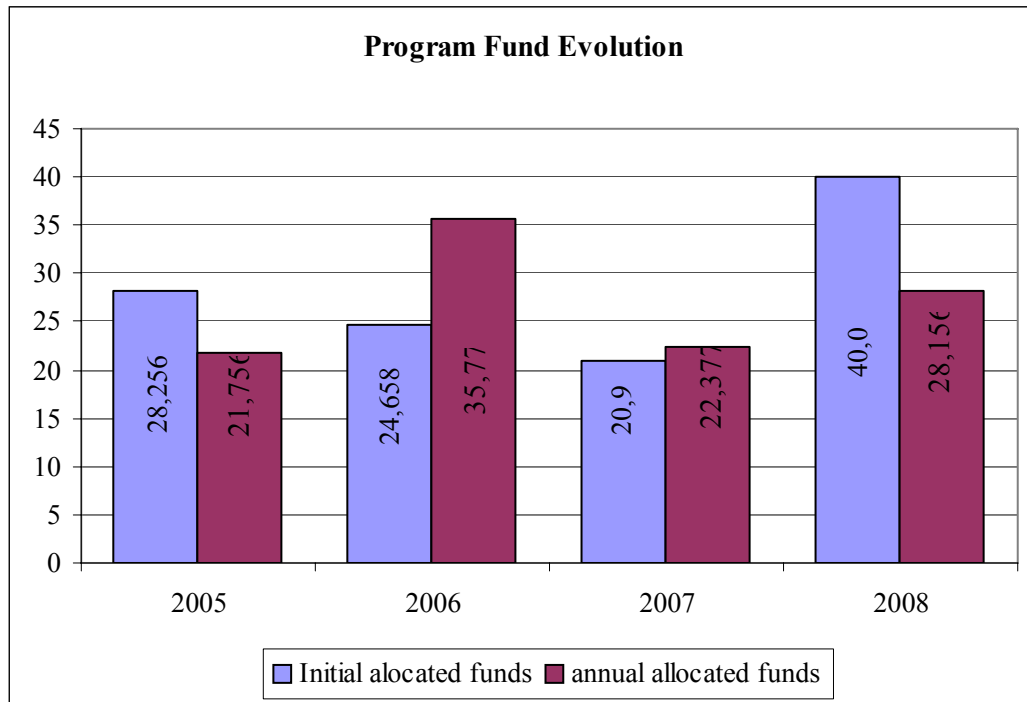
Source: Eurostat

The EU financial support for Romania in the period 2007 - 2009 was focused on helping our country to reduce negative social and economic impact of the adhesion due to different levels of economic development in comparison with the EU average. The amounts allocated exceed *15 billion Euros* and they are intended primarily for agriculture development and rural environment and for some regional development programs.

In the period 2005-2008 the government has acted to raise progressively the percentage allocation of financial resources, GDP, to stimulate and support SMEs. In 2008 the initial amount allocated from the state budget to finance programs intended to support development of SMEs, increased the competitiveness of SMEs and facilitated confrontation with competition from the EU is 40 thousand lei and increased in 2006 to 24,658 thousand lei and in 2007 to 23,377 thousand lei.

For "Program to improve the competitiveness of industrial products" number of projects submitted and the funds paid to beneficiaries have increased continuously, from 315 projects submitted in 2003 to 814 filed in 2005 and the highest percentage of accepted projects is 67.16% in 2007.

The accounting policies regarding the reinvested profits starting with October 1, 2009 according to Law 343/2009 the entity can reinvest profit so that the profits reinvested in production and / or acquisition of technological equipment, machinery, gears and work facilities as they are outlined in the catalogue on classification and the normal duration of operation of fixed assets used in order to obtain taxable income is exempt from tax.



Source: Ministry of Economy - Directorate General industrial policy and competitiveness

Figure 2. Evolution Program for funds to improve the competitiveness of industrial products in the years 2003 to 2007

The accounting policies on engaging to credits from various entities so that they can be fully deductible in calculating the income tax, stating that interests and exchange rate differences regarding loans obtained directly from international development banks, the state guaranteed, as well as those related to loans obtained from Romanian or foreign banking companies, credit unions, leasing companies for leasing operations, mortgage credit entities and other legal entities that provide credits, does not enter in establishment calculation of interest costs deductibility.

Irredeemable financings include government subsidies, public or private irredeemable financing programs and they are designed to support the development of activities - important for certain segments of society or the overall development of economic and social organization - in areas where, because of cyclical situation, there are not sufficient financial resources currently available (for example, rehabilitation of infrastructure in poor regions, retraining, supporting the development NGO sector as a

partner of public authorities) or in areas where, traditionally, the need for financial resources is greater than the availabilities (for example, activities with social character).

During the year 2006, the most common financing methods used by SME' s in Romania are: about 70% of SME' s have been self-financed, about 57% of them have obtained bank loans and 39% of the SME' s type of companies have used leasing.

In 2008 the financing modalities that SME' s managers have used are presented as it follows: 64.42% of the companies have self-financed, 51.05% of them have obtained bank loans, 29.57% of SME' s companies have used leasing and 8.74% *have resorted to irredeemable funds* and 3.91% have used factoring as a financing source, 3.09% had loans from specialized financial institutions, 2.73% accessed the National Loan Guarantee Fund for SME' s and 1.46% realized issues on the capital market.

In 2009 there are used according to the investigation conducted by the National Council of Private Small and Medium Enterprises in Romania (NCPSMER): self-financing (used by 86.7% of the surveyed firms), bank loans (60.1%) and leasing (53.2%).

The research conducted in 2009 showed that entrepreneurs use available funds primarily to purchase new machinery and equipment - 79.80% and secondly to finance current activities of the company - 75.86%. Almost 43% of firms use the available financial resources to produce products and new technologies, or to upgrade the existing ones.

Received from the state budget funds to finance development programs intended to support SMEs, increase the competitiveness of SMEs and facilitating the confrontation with competition from the European Union

Romania Governance Program of the Coalition government-PD-L PSD during the period 2009 - 2012 devotes a chapter *competitiveness, business environment and SMEs*, and has the objectives of the government *"Supporting small and medium enterprises to become competitive, according to the rules single internal market and not distort fair competition conditions* (Governance Program 2009 - 2012).

The registration in accounting of the receipt and use of irredeemable funds is made in accordance with *the provisions of the Order No. 3055/2009*. The entities that develop irredeemable funds in external financing Programs to reflect the accounting transactions generated by these programs will use the *accounting treatment which applies to grants*, their customization is not needed.

IAS 20 Accounting for Government Grants describes the reflection methods in accounting of the public subsidies and other public assistance regarding investments or business support.

The accounting reasoning used to reflect in accounting the irredeemable funds will take into consideration the financing contracts, as well as the accounting regulations and accounting policies applicable to the beneficiaries of funds.

Depending on the information associated with these funding sources and legal provisions specific for the activity funded by subsidies, the entities that use such sources will determine the sets of procedures and accounting policies which comply with the accounting principles, as well as with the contractual arrangements established between the parties. For example, in the case of investment subsidies, the income

replay of the amounts used for paying investment suppliers will be done as future investment costs will exist, namely by putting in operation, throughout its lifetime.

Starting with 01.01.2010 according to the Gazette 3055/2009 both irredeemable funds and actual subsidies, are recorded at their entry into the entity's assets as components of equity by crediting the adequate account from group 47 "SUBSIDIES, REGULARIZATION AND ASSIMILATED ACCOUNTS".

3. CONCLUSIONS

The importance of entity financing results from the fact that solving in a certain way these problems condition the survival of the entity, its development prospects, its performance and not least the desire for a major achievement defined by the very purpose of the entity's existence, namely maximizing its value.

For the proper application of accounting policies on financing is it first needed the existence of accounting policies and procedures manual within each entity, for all transactions carried out, starting from preparing documents to complete quarterly and annual financial statements and informing the staff from the financial accounting department on the procedure for awarding grants. Only by the collaboration of all departments within an entity for applying all implemented procedures, a reasonable presentation of grants in accounting can be reached, and finally of the entity's financial statements.

These procedures should be developed given the specific activity, by specialists in economic, technical and commercial domain, experts in the activity performed and of the strategy adopted by the legal person. Choosing a way of financing or another must also be based on the size of the marginal cost of the capital used. In other words, is not sufficient to compare the cost specific for each financing source but also an analysis of the cost of each additional unit of allocated capital so that a comparison can be made between the effects generated by the process of financing through various ways. One the advantage of irredeemable financing is that activities can be financed without consuming their own resources or to contract loans.

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