Considerations Regarding the Recording in the Entities' Accounting of the Instruments for Financing the Operating Activities

Traian Cristin Nicolae
„Ovidius" University of Constanta, Faculty of Economic Sciences, Romania
traian.nicolae.profesor@gmail.com

Abstract

Recent developments in the national economy have shown the need to diversify and make more flexible the instruments used to finance current operating activities. The often negative dynamics of the labor market, the massive restrictions on the provision of financing resources, the emergence of deficits / urgent working capital needs in certain sectors / subsectors / activities cause companies to worry about the financial resources needed to cover overdue payments. Transactions using equity instruments can be a solution in this context. Share-based payments / financial instruments, relative to the fair value of equity instruments, may form a flexible set of instruments to meet the requirements of ensuring a flexible financial package to support the operating activities of the entities .

Key words: financial instruments, accounting, trends.
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1. Introduction

Romania is facing a major economic crisis and is just beginning. As in many other countries, the number of unemployed has exploded. While many of us have stayed at home, restaurants, coffees shops and bars are closed. Most malls are closed, and all this is reflected in the unemployed. No one can afford to pay wages indefinitely while people stay at home without producing anything. For this reason, although the situation of many Romanians is very sad, they are not the only ones in this situation. At the beginning of April 2020, according to official data provided by the Ministry of Labour, over 1.1 million Romanians were sent unemployed (www.insse.ro). Contract terminations have taken place since April 6, and those affected by this decision are divided into two categories. About 950,000 have their employment contracts suspended, while a number of 190,000 people have their individual employment contracts terminated. In other words, the latter were fired (www.insse.ro).

Operating activities are the main revenue-generating transactions / cash flows for various entities, depending on the composition of the business in the declared object of activity. For this reason, identifying and allocating the cash needed to support operational activities is a key objective for entity managers. The issues raised by the use of financial instruments by entities in various fields, professional accountants, financial advisers are related to (https://eba.europa.eu) :

- financial instruments held for trading;
- loans and receivables;
- embedded / included financial instruments;
- convertible bonds with put options;
- strong foreign exchange supply contracts;
- recognition - derecognition of financial instruments ready to be purchased on the market;
- investments in order to be held to maturity;
- lowering of the entity's credit rating;
- portfolio composed of impaired individual assets;
- cash flow hedge accounting.

2. Theoretical background for accounting of financial instruments used for operating activities

A financial instrument is any contract that simultaneously generates a financial asset for one entity and a financial debt or equity instrument for another entity. More simply, financial instruments can be viewed as cash flows with certain risks, depending on the predictability of these flows (IASB , 2018) .

A financial asset is any underlying asset that represents (Nicolae, 2010) :

- cash;
- an equity instrument of another entity;
- a right stipulated in the contract to receive cash or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable;
- a contract that will be or can be settled in its own equity instruments and is a non-derivative financial instrument for which the entity is or may be required to receive a variable number of its own equity instruments or a derivative financial instrument that will be or it may be settled otherwise than by exchanging a fixed amount of cash or another financial asset for a fixed number of the entity's equity instruments.

For this purpose, the entity's equity instruments do not include instruments that are themselves contracts for the receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is (Nicolae, 2010) :

- a contractual obligation to divest liquidity or another financial asset to another entity or to exchange financial instruments or other financial liabilities with another entity under conditions that are potentially unfavorable to the entity;
- a contract that will be or may be settled in its own equity instruments and is a non-derivative financial instrument for which the entity is or may be required to receive a variable number of its own equity instruments or a derivative financial instrument that will be or it may be settled otherwise than by exchanging a fixed amount of cash or another financial asset for a fixed number of the entity's equity instruments.

To this end, the entity's own equity instruments do not include instruments that may themselves be contracts for the future receipt or delivery of the entity's own equity instruments.

Definitions of financial assets and financial liabilities include the terms financial asset, but the definitions are not circular. When a contractual right or liability arises to exchange financial instruments, the instruments to be exchanged give rise to financial assets, financial liabilities or equity instruments. A chain of contractual rights or liabilities may be established, but ultimately this leads to the collection or payment of cash or the acquisition or issuance of an equity instrument (Nicolae, 2010)..

Monetary financial assets and liabilities (also considered as monetary financial instruments) are financial assets and liabilities that are to be collected or paid in cash, for a specified or determinable amount.

Common examples of financial assets are: trade receivables and payables, trade receivables and payables, loans receivable and payable, and receivables and receivables.

3. Research methodology - Evolution of financial instruments used for operating activities - empirical aspects of research

Access to bank financing is still limited for many companies in Romania, so not even 2 out of 10 companies can turn to banks (www.insse.ro). Between the rigidity of banks and the lack of vision of companies, where does the change have to come from?

Only 15% of Romanian companies are bankable according to the indicators they report annually, ie they can access financing from banks, which outlines both a problem of entrepreneurs and businesses in terms of business capitalization on the local market, and a problem of understanding on the part of the banks (www.insse.ro) .

Of these, very few have a turnover of over 1 million euros, ie only about 10,000, being the only ones who can access a larger loan (www.insse.ro) . The rest are companies with a turnover of less than 1 million euros, so the investments are smaller.

But in a context where the economy is growing and the banks' business is still growing, why aren't there more bankable companies? In January 2020, loans in lei taken by companies and the population totaled 181.4 billion lei, of which loans to companies represent 72 billion lei, increasing by 4.5% compared to January 2020 (www.bnr.ro).

Banks are looking for profitable companies. Obviously, they will not credit a company that has been at a loss or one that does not have a business vision, which it does not explain so as to be sustainable and which does not say exactly what it wants to do with that money. Romanian companies are quite under-capitalized because the Romanian entrepreneur did not have this exercise to capitalize on his business, and this capitalization is a process that happens over time.

At the same time, banks look at capitalization indicators and how entrepreneurs understand and look at these indicators in the future. Moreover, the lifespan of a company can be important. Thus, small companies or start-up entrepreneurs, such as start-ups, are not the main investments of banks because they do not generate profits as large as a medium or large company.

Today, the Romanian economy is going through an exchange of generations that we all think we are observing and it is an exchange that also comes with challenges. Consequently, banks and companies need to understand very well what is the ecosystem in which lending and business take place today. Probably start-ups are just an investment in the future, because at a start-up you can't put too much money, as a bank.

Although start-ups need a history to prove their business idea, banks should not ignore these businesses, in the context in which Romanian entrepreneurs have started to deliver increasingly scalable projects.

In this process, a "learning curve" intervenes. Thus, start-ups can learn the steps in this tango in which they enter with the banks, and lending institutions can be educated in terms of "posture" - as they expect these entrepreneurs. Here is a learning curve, including for banks, that I can apply in the analysis of these startups. Because the entrepreneur is the one who knows best the trends in the industry in which he operates, he must know how to further explain this industry, which can be materialized in an experience that the bank can gain on that industry and that it can use from now on in the risk model it has.

4. Survey of the specific developments about financial instruments used for operating activities in Romania

In countries with a more developed business environment and in which the financing ecosystem has matured, credit institutions have an important role in financing entities, along with mixed capital structures and private capital (https://eba.europa.eu) .

We must first discuss the difference between bankable and fundable companies. The bankable ones are attractive for banks, and the financeable ones can also be attractive for private equity. It can be said that in Romania there are still few active investment funds, and they focus only on certain segments. At the same time, the fund can offer to buy debt, but also a stake in the company, and some companies only want to sell debt, because they only need a loan (www.bnr.ro).

An investment fund can come in two ways. He can give credit by practically buying debt, he can also ask for capital, or he can ask for a combination. The bank only wants debt, that is, it places money for an interest. Interest rates on private equity funds are higher than on banks. Moreover, the entrepreneur must want a private equity fund to become a shareholder. We appreciate that bank financing will continue to be a challenge for companies at the beginning of their journey in Romania, but in the case of well-developed business plans with an educated mentality of the bank, even these financings can prove to be a success (https://eba.europa.eu) .

If we talk about entrepreneurs at the beginning of the road is a challenge and will remain a challenge, but with a business plan, choosing the right bank, maybe even from the second year of experience could turn to banks. The challenge becomes more interesting for companies that have both size and activity. Companies must also dimension their activity according to the bank's products. For example, if you use factoring as a product in your activity, you have to go to a bank that has that product in its portfolio and that it does well (https://eba.europa.eu).

We say that local banks should try harder and harder to accept such financing and proactively ask for a business plan that is as well documented as possible from the entrepreneur. Moreover, banks must believe in the vision put on electronic support by the entrepreneur. When such a practice reaches maturity and habit on both the bank's and the entrepreneur's side, we reach a more advanced level of understanding and financial education on both sides (https://eba.europa.eu).

5. The observation of the accounting issues associated with financial instruments used for operating activities

Entities need to have a medium-term vision, because the short term can be extremely misleading. A medium-term vision must be a concern of entrepreneurs. This concern must be anchored in the factors that can influence their business and that are external. The better they understand this ecosystem, the more credible they will be to their business partners, as well as to the banks they borrow from. It is considered that banks cannot fight the phenomenon of supplier credit, which is growing from year to year in the Romanian economy and draws attention to the fact that it generates a bubble due to which the entire economy could suffer (www.insse.ro). Banks cannot fight supplier credit. At best they can force the entrepreneur to be more careful than he is. The concern must be with the companies. We are talking about a bubble, which, if it breaks, will all suffer. A more rigorous management of trade receivables is a concern that the entrepreneur must have for the health of his business. In general, the supplier credit is interest-free. Each small and medium-sized entity has become a kind of small bank for the ecosystem in which it operates.

The lending market to Romanian companies could be blown up by the entry of players from new industries (www.insse.ro). For example, the giant Amazon has announced that it will start lending to companies in the US, a move similar to the loans granted by the Chinese giant Alibaba for SMEs (https://eba.europa.eu). We appreciate that the Romanian market could also meet such new players and consider that such a move could be made even by the players in the telecom industry, who have a lot of capital at their disposal. Several players could enter the market, including telecom companies considering this option because they have a lot of cash available. They have a lot of cash, they have developed online platforms, they have an existing customer base, so it is a type of lending that does not start from scratch. But until it reaches a certain level of exposure in Romania, I think it will take some time (www.insse.ro).

A derivative instrument is a financial instrument or other contract within the scope that meets all three of the following characteristics (https://eba.europa.eu) :

- its value changes in response to changes in certain interest rates, the price of a financial instrument, the price of commodities, exchange rates, price or rate indices, the credit rating or lending index, or in other variables, provided that , in the case of a non-financial variable, this should not be specific to a contracting party (sometimes called a "support");
- does not require any net initial investment or a net initial investment that is lower than would be required for other types of contracts that are expected to have similar reactions to changes in market factors;
- is settled at a future date.

The main difference between derivatives and other financial instruments is that, in the case of derivatives, the buyer pays only part of the value of the underlying asset, but can fully benefit from the change in the price of this asset (https://eba.europa.eu).

Over the last 30 years, the use of derivatives has increased, especially as a result of changes in the world economy (https://eba.europa.eu).

Derivatives allow companies to manage or adjust the specific risks to which they are exposed in order to stabilize their cash flows (https://eba.europa.eu). Thus, companies reduce their trading costs and invest when the time is right, not when they happen to have cash. Firms can protect themselves against some of these risks through "natural" methods. For example, they can hedge against currency risk by setting up factories in the countries where they want to sell. But such methods of controlling financial risks are often difficult to apply in practice. Derivatives offer a much more effective way to hedge specific risks.

6. A case study of the accounting records for financial instruments used for operating activities

On Jan 1, 2020, the entity grants 200 shares to 10 employees in the management sector at the price of 5,000 m.u. (monetary unit) per share. (Nicolae, 2010).
The granting of equity instruments is spread over a period of 4 years.
The recording accounts used (as proposed in the IFRS accounting plan) for the exemplification of these accounting records were selected based on the formulated assumptions (Nicolae, 2010).

Accounting data
(Making entries by the author)

Registration of granted capital instruments :
Total fair value of equity instruments granted = 10 employees x 200 shares x 5,000 m.u. =
= 10,000,000 m.u.

1. Recognition of expenses for year 2020 = 10,000,000 m.u. x 1/4 = 2,500,000 m.u.

Debit *Expenditure on remuneration in equity instruments* 2,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options* 2,500,000

The profit tax related to the non-deductible expenses is calculated for year 2019:
Income tax calculated = 2,500,000 m.u. x 16% = 400,000 m.u.

Debit *Current income tax expenses* 400,000
Credit *Current income tax* 400,000

2. Recognition of expenses for year 2021 = 10,000,000 m.u. x 1/4 = 2,500,000 m.u.

Debit *Expenditure on remuneration in equity instruments* 2,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options* 2,500,000

The profit tax related to the non-deductible expenses is calculated for year 2020:
Income tax calculated = 2,500,000 m.u. x 16% = 400,000 m.u.

Debit *Current income tax expenses* 400,000
Credit *Current income tax* 400,000

3. Recognition of expenses for year 2022 = 10,000,000 m.u. x 1/4 = 2,500,000 m.u.

Debit *Expenditure on remuneration in equity instruments* 2,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options* 2,500,000

The profit tax related to the non-deductible expenses is calculated for year 2021:
Income tax calculated = 2,500,000 m.u. x 16% = 400,000 m.u.

Debit *Current income tax expenses* 400,000
Credit *Current income tax* 400,000

4. Recognition of expenses for year 2023 = 10,000,000 m.u. x 1/4 = 2,500,000 m.u.

Debit *Expenditure on remuneration in equity instruments* 2,500,000

Credit *Benefits granted to employees in the form of equity instruments - stock options* 2,500,000

The profit tax related to the non-deductible expenses is calculated for year 2022:
Income tax calculated = 2,500,000 m.u. x 16% = 400,000 m.u.

Debit *Current income tax expenses* 400,000
Credit *Current income tax* 400,000

5. Exercising options in 2023 :
The balance of the account "Benefits granted to employees in the form of equity instruments - stock options" is = 10,000,000 m.u

Debit *Benefits granted to employees in the form of equity instruments - stock options* 10,000,000
Credit *Paid subscribed capital* 2,500,000

When implemented in practice, entities may also consider other accounting records alternatives as long as there is a fair presentation of the results in profit or loss and in the statement of financial position.

7. Conclusions

In my opinion, the expansion of the use of share-based payments by various companies ensures a positive trend in terms of the flexibility of salary packages granted to employees.
In the current context, of an economic, financial, social environment marked by major elements of unpredictability, the use of remuneration instruments with share-based payments is a factor of employee loyalty.

8. References

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