

Current Issues Regarding the Recording in Accounting of the Financial Instruments for Financing the Activity of the Entities

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Abstract

The use of financial instruments is a relatively small phenomenon in the context of the current Romanian economy. However, we can see an increase in the use of financial instruments to finance the current and future activities of entities in the national economy. The problems raised by a relatively difficult access of economic entities to financing resources - bank lending, in the set of restrictions generated by the epidemiological context, are a stimulating factor for increasing the use of financial instruments. In this paper, in a simplified manner, we try to highlight some problems that have arisen in the context of the implementation of financial instruments in the accounting of Romanian entities. The applicability of financial instruments to the needs of companies is a segment in which the legislature must intervene with appropriate regulations, necessary for efficient operation. Providing technical support, software applications is an underdeveloped segment today.

Key words: financial instruments, accounting, trends

J.E.L. classification: M41, G32

1. Introduction

The total lending for the population and companies reached in January 2021 a balance of 283.5 billion lei. Loans in lei advanced by 8.8% compared to January 2020, while foreign currency loans decreased in January by 2.3% year / year. Total deposits made an annual jump of 15.8% in January, over 422 billion lei. (www.insse.ro)

Total private credit started 2021 with an annual increase of 5.1% compared to January 2020, the pace slowing down compared to the first months of last year, and the balance of loans to households and companies reached 283.5 billion lei (www.insse.ro).

In comparison, in January 2020 private credit increased by 6.9% compared to January 2019. Over the whole year 2020, the balance of private credit registered an average increase of about 5.1% compared to January - December 2019, decreasing compared to of the average advance of 7.6% from 2019, in the conditions of the unfavorable effects brought by the coronavirus crisis. (www.insse.ro)

The year 2020 was an extraordinary year and full of many challenges. In addition to the fact that we have faced an unprecedented economic shock, generated by the pandemic, we have suddenly had to, like all European citizens, isolate ourselves at home and contact our colleagues only through virtual means. Many of us have had a relative, friend, or colleague who has contracted the coronavirus. Unfortunately, I lost some of my colleagues during this pandemic.

Banks have entered the pandemic crisis in much better shape than at the beginning of the previous crisis. As the crisis became more widespread, some banks were overwhelmed by very high levels of credit applications, especially after the introduction of state aid programs for state-guaranteed loans and moratoriums on repayments. But these banks have managed to adapt quickly and have helped ensure a syncope-free lending flow of businesses and households. Loans to businesses and households continued to grow in 2020, although they slowed in the third quarter. Compared to what happened during the great financial crisis, banks reported a much more moderate tightening of lending standards after the first wave of the pandemic. (www.insse.ro)

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

Financial instruments are generally the legal obligations of a party to transfer an asset / value (usually cash) to another party at a future date and under certain conditions. (Nicolae, 2010)

Financial instruments are, in fact, assets that can be traded. These assets can be cash, contractual rights to deliver or receive money or another type of financial instrument or proof of ownership over an economic entity. (Nicolae, 2010)

They can also be in the form of capital packages that can be traded. Most types of financial instruments provide an efficient flow of capital transfer into the world of investors.

Examples of financial instruments (Nicolae, 2010):

- Bank deposit. It is the simplest, most common and used investment financial instrument. If you deposit a sum of money in a savings account at the bank you will receive an interest in return;

- Actions. Suppose you want to buy 100 shares in a company like Microsoft, Apple, Google or Banca Transilvania. These are financial instruments;

- Obligations. You have certainly heard of treasury securities, government bonds, ie, for example, bonds issued by the Romanian Ministry of Finance. And these are a kind of financial instrument;

- CFDs (contracts for exchange rate differences). Maybe you have a trading account opened with a forex broker. You can trade EUR / USD and GBP / USD via a trading platform. All currency pairs are financial instruments.

The characteristics of financial instruments are as follows: (Nicolae, 2010)

- They are complex contracts, often standardized;

- The obligation to execute the related contract is important;

- Financial instruments oblige a party (person, company or government entity) to transfer an asset / cash to the other party;

- The financial instruments expressly specify that the payment is to be made at a certain date in the future;

- The financial instruments specify certain conditions regarding how the payment will be made.

The functions of the financial instruments can be summarized as follows:

- Financial instruments act as means of payment (just like money). For example, employees may receive actions in the form of payment for work performed;

- Financial instruments act as value deposits (in the same way as money);

- Financial instruments generate higher returns and therefore higher increases in wealth than hoarding cash;

- Financial instruments can be used as a means of transferring purchasing power in the future;

- Financial instruments allow the transfer of risks (which money does not allow);

- Futures and insurance contracts allow the transfer of risks from one entity to another.

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

An equity instrument is any contract that certifies the existence of a residual interest in an entity's assets after deducting all of its liabilities (IASB , 2018).

Fair value is the amount for which an asset may be traded or a liability may be settled, between interested parties and knowingly, in the event of a transaction being made under objective conditions (IASB , 2018).

A derivative instrument is a financial instrument or other contract within the scope that meets all three of the following characteristics (Nicolae, 2010):

- 1) 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 credit index, or in other variables, provided that, in the case of a non-financial variable, it is not specific to a contracting party (sometimes referred to as a "support");

- 2) 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;

- 3) is settled at a future date.

There are a multitude of financial instruments, but the best known are (Nicolae, 2010) :

- Forex Spot;
- Actions;
- Futures;
- Options;
- ETFs (exchange traded funds);
- Mutual funds;
- Bonds;
- Contracts for difference (derivatives on specific underlying financial instruments);
- Bank deposits, bank loans, mortgages;
- Cash and cash equivalents.

These are the most popular, but there are many other financial instruments such as:

- Preference rights of shares;
- Rights of allotment of shares;
- Share allocation rights;
- Stock certificates of deposit;
- Warrants;
- Swaps;
- Forward Contract;
- Money market instruments.

The term financial assets is commonly used and refers to documents that confirm the money rights of the holder, both on the asset itself and on the income it generates (eg dividends, interest).

Financial assets are the cash equivalent of real assets. For example, a share is the cash equivalent of a fraction of a company's real capital.

Financial assets fall into two categories:

- banking assets - are associated with operations performed by banks and other financial institutions;
- non-banking assets - are associated with investments and are more precisely the securities that are traded. Non-bank assets can be of two types: monetary assets and capital assets.

Non-banking assets are materialized in financial securities. Financial securities are electronic or paper documents that confirm the existence of a contractual relationship between the holder and the issuer and guarantee the rights of the holder.

Financial securities are securities or credit securities. The securities are:

- Commercial securities - used in commodity markets;
- Non-commercial securities:
 - o Securities related to short-term operations - monetary instruments;
 - o Securities related to long-term operations - equity instruments (shares and bonds are those that fall into this category).

Financial securities are characterized by value.

- The intrinsic value of the security is calculated based on the results of the investment and the forecasted future income;
- The market value is given by the market, depending on the demand and supply of that thread and the expectations of those who participate in that market;

Financial securities can also be classified into:

- securities issued for equity mobilization - equity instruments (equity instruments), in this category we include shares;
- securities issued to attract capital through loans - debt instruments (debt instruments) - this category includes bonds.

The main feature of financial securities is that they provide long-term capital requirements for entrepreneurs and give holders pecuniary rights over the issuer's income. More specifically, the investor becomes a direct partner of the entrepreneur in terms of profit and risk.

4. Findings - Survey of the specific developments about financial instruments used in accounting in Romania

Shares are financial securities issued by an economic entity for equity operations, ie growth, restructuring or even incorporation. They are variable-income securities, as they are remunerated according to the results generated by the financial year and the issuer's profit-sharing policy (Nicolae, 2010) .

The total number of shares issued by an economic entity constitutes the share capital. At issue, the share capital is divided by the number of shares and the nominal value of the share results.

Characteristics of the actions (Nicolae, 2010):

- They are tradable instruments;
- There are equal fractions of the share capital characterized by nominal value;
- They are indivisible.

Depending on the rights conferred by the actions are:

- Joint actions (ordinary);
- Preferential shares.

The common shares are the most used and give the owner:

- The right to vote at the general meeting of shareholders;
- The right to dividends, if the economic entity distributes the profit, the holder has a part of it.

The issue of common shares is the simplest method of attracting capital because it does not imply a future due date.

Depending on how you identify it:

- Bearer shares;
- Registered shares.

Registered shares specify the name of the holder, may be in material form (paper) or may be dematerialized (in the form of account documents).

The bearer shares do not expressly indicate the name of the holder, they only have the physical form and can be transmitted without formalities. The person presenting the document is considered a shareholder (IASB , 2018).

The general meeting of shareholders may decide whether bearer shares may be converted into registered shares and vice versa.

Investors in common shares have the opportunity to obtain the following types of income:

- Din dividends;
- Capitalization gains - depends on the company's potential;
- Potential gains from speculation.

The preferred shares guarantee a minimum return based on a priority dividend, which is paid before the dividends for the common shares and also confers ownership. Holders of preferred shares do not have the right to vote at the general meeting of shareholders (IASB , 2018).

Actions can also be classified according to the stage of self-financing:

- authorized actions;
- unissued shares;
- shares put up for sale;
- shares available in the market;
- hoarded shares;

When the acquisition of shares is pursued, they are evaluated on the basis of financial indicators / multiples. Among the most common are (IASB , 2018):

- Earnings per share;
- Dividend per share;
- Yield of an action;
- Dividend distribution rate;
- The value of future dividends.

Stock certificates of deposit are used in situations where a foreign company wishes to list shares previously admitted to trading on a foreign regulated market. In order to be admitted to trading on a given market, the issuer must meet the criteria required by that market.

Certificates of deposit can be traded on the capital market and can also be issued through an initial public offering.

Stock certificates of deposit are a financial instrument used by foreign companies listed on developed capital markets to gain access to foreign markets and foreign investors, without meeting the requirements for admission to trading in those markets, which can sometimes be difficult to meet. fulfilled.

The investor in certificates of deposit has the same rights as the holder of common shares, the right to dividends and the right to vote in the meeting of shareholders. The rights of these investors are listed in the prospectuses of the certificates of deposit.

Warrants are securities similar to preference rights and are issued for longer periods of time. They usually appear on the market in association with a stock or bond and may be issued in series.

Warants have both conversion and trading value, their price changes in proportion to the price of the security with which they are associated (Nicolae, 2010).

In the market, the value of a warant is composed of intrinsic and prime value.

Intrinsic value refers to the difference between the current market price of the action and the fixed price at which the warrant for the action in question was issued.

The first refers to the difference between the market value of the guarantor (assuming it is traded on the secondary market) and its intrinsic value.

Bonds are financial instruments with a fixed income, securities that give the holder a right of claim over the issuer. The issuer of bonds can be the state, another public entity or a company.

With the help of the bonds, the issuer mobilizes capital through the loan, and the holder receives the right to collect interest for the loan period until maturity, when the issuer undertakes to redeem them.

Bonds are fixed income securities and are interest-bearing. The interest can be both fixed and variable.

Types of bonds (Nicolae, 2010):

- mortgage: the debt is secured by mortgage on the assets of the issuing entity;
- general: it is a receivable on the total assets of the issuing entity;
- insured: bonds secured by third-party securities, deposited with a guarantor and held by the issuer;
- convertibles: the holder has the possibility to convert them into shares of the issuing entity;
- retractable: the bonds are repurchased at maturity by the issuer;
- with redemption fund: the issuer creates a fund that it constantly feeds in order to redeem the bonds at maturity.

Depending on the issuer, the bonds may be:

- Corporate bonds;
- Government bonds.

Shares and bonds together with special products based on the rights associated with the shares (allocation, allotment, preference, warrants and certificates of deposit on shares) are considered the primary products of the capital markets.

5. The observation of the accounting issues associated with financial instruments used in accounting

Derivatives allow companies to manage or adjust the specific risks to which they are exposed in order to stabilize their cash flows. Thus, companies reduce their trading costs and invest when it is the right time, 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 (Nicolae, 2010).

A forward contract is a firm agreement in which one party agrees to buy and the other party agrees to sell an asset (a commodity, a currency, a security) in a specified quantity and quality. , at a specified future date and a certain price. They must be accounted for as derivative instruments. They meet the definition of a derivative instrument because the initial net investment is very small or does not exist,

there is a basic variable (interest rates) and they will be settled in the future.

Example of forward contract

It's the beginning of September and you decide you want to buy a new car. Choose the type of car you want and go to your local dealer. (Nicolae, 2010)

In the dealer's showroom, you decide on the exact specification of the car - color, engine, size, steering wheel shape, etc. - and, most importantly, set the price. The supplier will tell you that if you place your order today and make a deposit, you can pick up the car in three months. Even if within this three-month period, the supplier grants a 10% discount for all new cars, nor if the price of the model increases, it does not matter to you. The price you pay on delivery has been agreed and fixed between you and the supplier. . You have just entered into a forward contract - you have the right and obligation to buy the car in three months at the agreed price.

Forward (forward) contracts are not traded on the stock exchange and do not present standardized, transparent conditions. A forward contract involves a credit risk for both parties, similar to the spot market. In such conditions, the contracting parties may request a guarantee (collateral), in the sense that the other party will honor the contract (Nicolae, 2010).

Normally, forward contracts are not negotiable, it is a private negotiation and when the contract is initiated, it has no value. No payment is involved, as the contract is a simple agreement to buy or sell at a future date (Nicolae, 2010).

The advantage of users of forward contracts consists in knowing the costs and revenues in advance compared to the actual deliveries of goods. The certainty of the price is accompanied by that of the quantity and quality of the goods engaged in the contract.

Mainly, the forward price is determined by taking the spot (cash) or cash (cash) price at the time of the transaction and adding to it the "cost of carry".

Depending on the underlying asset or reference commodity of the contract, the running cost takes into account payments and receipts for items such as storage, insurance, transportation costs, interest payments, dividend receipts, etc. (Nicolae, 2010)

The characteristics of forward contracts are the following:

- agreement between two parties to deliver / pay at a predetermined date an asset (commodity, currency, financial asset), at a predetermined price,
- is concluded outside the stock exchange, through direct negotiation between the parties,
- is a non-standard contract,
- has a fixed value, and the potential result is given at maturity by the difference between the established price of the contract (forward price) and the current price (spot) of the asset,
- the forward contract is liquidated at maturity, in kind (delivery of the asset / payment of the equivalent value, at the contract price).

Example of applying the standards in accounting for forward purchase contracts for the entity's own shares that will be settled:

- a) net in cash,
- b) net in shares or
- c) by delivering cash in exchange for shares.

To simplify, it is assumed that no dividends are paid for the basic shares (ie the carried forward profit is zero), so that the present value of the forward price is equal to the spot price (at sight) when the fair value of the forward contract is zero. The fair value of the forward contract was calculated as the difference between the market price for the shares and the present value of the fixed forward price.

Example

Cash against cash ("net cash settlement")

(Making entries by the author)

The forward purchase contract for the entity's own shares will be settled net in cash, ie the entity's own shares will not be received and delivered upon settlement of the forward contract.

On February 1, 2022, Astrix entered into a contract with Beldix to receive the fair value of 1,000 of the outstanding common shares of Entity A by January 31, 2023 in exchange for payment of 104,000 m.u. (monetary unit) in cash (ie 104 m.u. per share) on January 31, 2023. The contract will be settled net in cash. (Nicolae, 2010)

On February 1, 2022

The price per share when the contract is concluded on February 1, 2022 is 100 m.u. . The initial fair value for the forward contract on February 1, 2022 is zero.

No registration is required because the fair value of the derivative is zero and no cash receipts or payments are made.

On December 31, 2022

The price per share increases to 110 m.u. and, as a result, the fair value of the forward contract increases to 6,300 m.u.

Registration of the increase of the fair value of the forward contract:

Debit *Asset Forward* 6,300

Credit *Profit and loss* 6,300

On January 31, 2023

The market price per share decreased to 106 m.u. The fair value of the forward contract is 2,000 m.u. = (106 u.m. x 1,000) - 104,000 m.u.

On the same day, the contract is settled in cash. The Astrix entity has the obligation to deliver 104,000 m.u. to the Beldix entity, and the Beldix entity has the obligation to deliver 106,000 m.u. to the Astrix entity, so the Beldix entity pays the net amount of 2,000 m.u. to the Astrix entity.

Recording the decrease of the fair value of the forward contract (ie 4,300 u.m. = 6,300 u.m. - 2,000 m.u.):

Debit *Profit and loss* 4,300

Credit *Asset Forward* 4,300

Registration of the forward contract settlement:

Debit *Bank accounts* 2,000

Credit *Asset Forward* 2,000

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

On Jan 1, 2021, the entity grants 100 shares to 50 employees in the management sector at the price of 10,000 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 = 150 employees x 100 shares x 10,000 m.u. =
= 150,000,000 m.u.

1. Recognition of expenses for year 2021 = 150,000,000 m.u. x 1/4 = 37,500,000 m.u.

Debit *Expenditure on remuneration in equity instruments* 37,500,000

Credit *Benefits granted to employees in the form of equity instruments - stock options*
37,500,000

The profit tax related to the non-deductible expenses is calculated for year 2021:

Income tax calculated = 37,500,000 m.u. x 16% = 6,000,000 m.u.

Debit *Current income tax expenses* 6,000,000

Credit *Current income tax* 6,000,000

2. Recognition of expenses for year 2022 = $150,000,000 \text{ m.u.} \times 1/4 = 37,500,000 \text{ m.u.}$

Debit *Expenditure on remuneration in equity instruments* 37,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options*
37,500,000

The profit tax related to the non-deductible expenses is calculated for year 2022:
Income tax calculated = $37,500,000 \text{ m.u.} \times 16\% = 6,000,000 \text{ m.u.}$

Debit *Current income tax expenses* 6,000,000
Credit *Current income tax* 6,000,000

3. Recognition of expenses for year 2023 = $150,000,000 \text{ m.u.} \times 1/4 = 37,500,000 \text{ m.u.}$

Debit *Expenditure on remuneration in equity instruments* 37,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options*
37,500,000

The profit tax related to the non-deductible expenses is calculated for year 2022:
Income tax calculated = $37,500,000 \text{ m.u.} \times 16\% = 6,000,000 \text{ m.u.}$

Debit *Current income tax expenses* 6,000,000
Credit *Current income tax* 6,000,000

4. Recognition of expenses for year 2024 = $150,000,000 \text{ m.u.} \times 1/4 = 37,500,000 \text{ m.u.}$

Debit *Expenditure on remuneration in equity instruments* 37,500,000
Credit *Benefits granted to employees in the form of equity instruments - stock options*
37,500,000

The profit tax related to the non-deductible expenses is calculated for year 2022:
Income tax calculated = $37,500,000 \text{ m.u.} \times 16\% = 6,000,000 \text{ m.u.}$

Debit *Current income tax expenses* 6,000,000
Credit *Current income tax* 6,000,000

5. Exercising options in 2024 :

The balance of the account "Benefits granted to employees in the form of equity instruments - stock options" is = $150,000,000 \text{ m.u.}$

Debit *Benefits granted to employees in the form of equity instruments - stock options*
150,000,000
Credit *Paid subscribed capital* 150,000,000

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, there are multiple elements that need to be considered in order to be able to widely implement financial instruments in the day-to-day work of the entities.

We need to consider creating a complex and flexible legislative, fiscal framework that allows and stimulates at the same time the concrete applicability of the types of financial instruments for

financing the activity of entities. The legal norms must be issued in variants adapted to the legislative context at European level, simultaneously with the consideration of the specific features of Romania.

The pressure of the galloping technological evolution is another factor that must be taken into account with priority in the institutional effort of large-scale adoption of financial instruments in the current and future activities of Romanian companies. The widespread use of Information Technology (IT) tools, the applicability of new hardware and software solutions is an element with increasing impact on economic activity.

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