EXTERNAL FINANCING FOR CONSTRUCTION ENTITIES

ADELA BREUER, MIHAELA LESCONI FRUMUŞANU, BEATRIX LIGHEZAN BREUER, DOREL JURCHESCU *

ABSTRACT: *The external financing of the construction entities does not differ from the one of other entities within other activities, but the construction entities have also a financing source, represented by the funds for the site organization, funds which are analysed and accounted in the present paper.*

KEY WORDS: *financing; credits; funds for the site organization; leasing.*

JEL CLASSIFICATION: *M41.*

1. INTRODUCTION

Like for the other companies from other economy branches, the companies from the construction field include in the category of long-term debts the long-term bank loans with afferent interests and other long-term debts, such as leasing. The structure of the sources of financing is different according to the type of the company.

In this crisis, where their funding sources are becoming increasingly limited, the main way companies are being borrowed sources.

Financing is the entities, in special the construction 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 (Nagy, et al., 2010).

The category of external financing sources includes also the bond credits, the medium and long loans, and other medium and long term debts. If we calculate the cost of these funding sources based on the preferences of economic entities, we see that the

* *Lecture, Ph.D., "Eftimie Murgu" University of Reşiţa, Romania*
Assist. Prof., Ph.D. Student, West University of Timişoara, "Eftimie Murgu" University of Reşiţa, Romania, mihaelafrumusanu@yahoo.com
Assist. Prof., "Eftimie Murgu" University of Reşiţa, Romania
Ph.D. Student, West University of Timişoara, Romania, doreljurchescu@yahoo.com

first places are occupied by bank loans and leasing, this because of the accessibility but also because of traditionalism.

2. BOND CREDITS

These are based on a bond issue that is "a long-term debt created by the sale of debt securities traded by the public." Sinecvanon conditions for a company to issue bonds are: the company should be a corporation; the shares should be listed on a stock exchange. In Romania, this type of credit is at its beginning, the law governing the bond credits being issued in 2002, i.e. Law 525/2002 regarding the securities and the stock exchanges.

The bond credit has the following characteristics (Law 525/2002 regarding the nominal values and the stock market, updated 2010):

- the loan amount cannot exceed ¾ of the existing share capital according to the last approved balance sheet;
- the interest rate, the nominal value of a bond and the issue price have to be stated from the beginning;
- the value or the refund price must be at least equal to the nominal value, if not higher; the loan period should be more than one year;
- the value of the bonds must be fully deposited.

IAS 32 „ Financial instruments: Presentation" does not use the term of bonds, but refers to them as being financial instruments and defines them as being „any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity"(IFRS. Official norms issued on 1st January 2009, IAS 32 „Financial instruments: Presentation", p.1616) and the financial liability or the financial asset are recognized if the following conditions are met (IFRS. Official norms issued on 1st January 2009, IAS 32 „Financial instruments: Recognition and evaluation", pp.2073-2074):

- the financial asset, i.e. the financial debt are held for trading, being acquired and incurred for sale and resale;
- at first glance, the asset, i.e. the financial debt is evaluated at their fair value through profit or loss.

The valid legislation in Romania (OMFP 3055/2009 for the approval of accounting norms corresponding to European directives, published in the Romanian Official Gazette, Part I, no. 766 from 10th November 2009) presents loans from bond issues in the category of long term loans, not using the term of bond credit, stating that the loans from the issues must be separated from the convertible bonds.

Although the empirical studies conducted in Caras-Severin didn't lead to the existence of this type of credit, we consider that the bond credit should be regarded with more confidence and should be used more often by the companies that have this option, because there is the possibility for the refund value to be equal to the issue value, which would lead to loan costs far lower than in the case of conventional lending by banks.

The accounting of bond credits is held with the help of the account 161 „Loans from bond issues", and the afferent interests are marked out through the account 1681

„Interests afferent to the credits from bond issues”. Companies in the construction industry, just like any other economic entities which have contracted bond credits will use the two accounts.

3. LONG TERM BANK LOANS

The long term bank loans are loans received from banks and other financial institutions, they have a chargeability of over one year and bear interests (Paraschivescu M.D., Radu F., 2008).

The main goal of the economic entities in the contracting of a long term loan is the credit cost, represented mainly by the interest afferent to the credit, but we also have to include the granting and management fees, some banks calculating the margin credit risk which increases the credit cost for the entities with a lower profitability level, i.e. a lower debt service (Dragotă V., Dragotă M. et.all., 2005).

The costs of long-term loans are regarded as the borrowing costs of international accounting standards, and are defined as “interest and other costs incurred by an entity for the borrowing of funds” (IFRS. Official norms issued on 1st January 2009, IAS 32 „Loan costs,”, p.1446).

IAS 23 „ The borrowing costs” is the one that states that, when the loans are contracted for the acquisition, the construction and the production of an asset, all the costs afferent to borrowing will be recognized as costs afferent to the respective asset, their inclusion in the expenses being totally wrong, while the valid national legislation entitles our option, stating that „the borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset may be included in the cost of that asset.” (OMFP 3055/2009 for the approval of accounting norms corresponding to European directives, published in the Romanian Official Gazette, Part I, no. 766 from 10th November 2009).

We subscribe to the set of International Accounting Standard IAS 23 “Borrowing Costs”, and we believe that the costs of long-term loans obtained and used for acquisition, construction or production of a long-term asset, if attributed credibly to that asset, must be included in the cost of that asset, in order not to distort the financial result.

Regardless of the field in which they act, all economic entities keep records of long term loans with the account 162 “long-term bank loans”, and the records of these loans interests is made with the account 1682” Interest of long-term bank loans” .

4. LEASING CONTRACTS. OTHER LOANS AND PAYABLES

Leasing is a medium or long term financing technique, as an alternative to debt, allowing a better exploitation of a good without having to resort to loans or equities. (Dragotă, et al., 2005)

The national legislation on leasing (O.G. nr. 51/1997 regarding the leasing operations and companies, updated 01.01.2010) speaks of two types of leasing contracts:

- Operational leasing supposes that the locator provides the user with the asset of the leasing contract, without taking it out of its accounting records leasing;
- Financial leasing is considered to be financial if the risks or benefits associated with the contractual goods pass on the user, or the use period of the asset in the leasing system covers at least 75% of the normal use period, or the parties have stipulated in the leasing contract that at the expiry date the lessee is to be made owner (Law 571/2003 corroborated with the Government Decision 44/2004 regarding the fiscal code with application methodological norms, update 2010).

As mentioned in the previous chapters, there are views (Feleagă N., Ionaşcu I. , 1998) according to which the category of medium-or long-term loans should include only the finance lease contracts. In fact, if we look at the definition given above to leasing, which states that it is a financing technique but not a loan, then we must consider the perspective from which, however, the lease is registered as a medium or long term debt.

In order to affirm if the leasing contracts fall within the category of loans or not, and precisely because „the impact of the leasing operation on the accounting situations of the locating company is different, depending on the contracted leasing type", we must analyse the problem from the point of view of the economic primacy over the legality or the legal primacy over economics (Ristea, et al., 2009):

- In the case of the former the solution is to account the good obtained after closing the leasing contract as an asset and the sum that will be paid as a debt;
- In the case of the latter, the good is not registered in the asset category but recorded in the order accounts, i.e. outside the balance sheet;

In order to determine which of the two contracts should be classified as medium-and long-term debt, we make reference to IAS 17 "Leases", which states referring to finance leases that "at the commencement of the lease, the owners must recognize the financial leasing operations as assets and liabilities [...] transactions and other events are presented in accordance with their economic substance and financial reality, not just with their legal status" (IFRS. Official norms issued on 1st January 2009, IAS 32 „Leasing contracts", p.1230). With respect to operating leases, the same IAS 17 "Leases" makes clear that payments for such contracts will be recognized as an expense, the owner has the obligation, among others, to present, in detail, the "basis for determining the quota rents", i.e. the operating lease is a long term lease, by recognizing the rent (monthly payments) without the balance (contingent liabilities).

We align to the International Accounting Standards, considering that, in the category of medium and long-term debt we should include only financial leases because through the careful analysis we observe that they are almost entirely financial contracts (property rights are not directly transferred, but the rest of the bonds and rights go to the lessee), while operating leases should be recorded only off-balance sheet and not as it is the case of some companies, off-balance sheet and as a long-term debt. The off-balance sheet record of the operational leasing contracts is supported by the fact that for these contracts, the amortization of assets is registered to the lesser, the lessee registering only a rent expense until the end of the contract

5. PARTICULARITIES REGARDING THE EXTERNAL FINANCING OF THE CONSTRUCTION ENTITIES

The construction entities, just like any other economic entity, use the account 167 "other loans and payables" in order to highlight the leasing contracts, and in order to mark out their interests, we use the account 1687 „Interests of other loans and payables".

A specific source of construction works constitutes the site organization funds.

The organization of a site requires the solving of a series of problems that refers to insuring the conditions for the development of the basic activity, headed especially towards the creation of places, utility networks, communication paths, as well as workshops, concrete plants.

As previously indicated, the site organization works suppose the total of arrangements, constructions, plants, objects and expenses necessary to the creation of the conditions for the efficient use of the investment funds, and for the successful development of the activity.

The site organization is the first stage that develops within a construction. After the extent of the site organization activity, we can say that it resembles to a construction activity in miniature. This stage supposes team work for the arrangement of the territory on which the effective construction will start; the arrangement supposes digging and land levelling, supplying the area with water, natural gas, electricity, organizing and even building storages for materials; it also supposes accommodation for workers, creation of access roads for equipments and machineries, etc. All these activities mean expenses for the entrepreneur, expenses that must be kept at a low limit. Usually, the part allotted to the site organization in the work estimate, is the part where we can negotiate the final price of the construction, the site organization with a rate between 15% and 20% of the total cost estimate.

Currently, the site organization is not accounted, the sums received as advances being accounted and discounted as in the case of advances received fro works, thus:

- encashment of advances for the site organization:

512 Bank accounts	=	419 Clients - creditors

- record of expenses made for the site organization:

%	=	%
60x Expenses for materials		3xx Stores
61x Expenses for services executed by third parties		4xx Third parties

62x Expenses for other services executed by third parties 64x Expenses for staff and social protection		5xx Liquidness

- invoicing of the executed site organization works:

4111 Clients	=	%
		704 Incomes from executed works
		4427 Collected VAT

- advance discount:

419 Clients - creditors	=	4111 Clients

- encashment of the difference from the clients

512 Bank accounts	=	4111 Clients

We require separate accounting of the site organization as it is an important part of the final construction, a part which ensures the good development of the works, and if well executed, the site organization can lead to the completion within the estimated time. Unfortunately, the practice in accounting contradicts the theory, because there are only a few companies that hold the separate accounting record for the site organization.

We consider that the advances received for the site organization should be separately accounted, by constituting a fund that should encash from the client, and which after use, passes to incomes. We impose the creation of the following accounts:

- The account 1678 „ Funds for the site organization", which would have the accounting function of a passive, crediting with the encashed sums through the bank account and debiting by their passing to 7585 „Incomes of the site organization";
- The account 7585 „Incomes of the site organization", which would hold records of the incomes obtained from the site organization, helping to the discount of the works performed for the site organization, discounting at the end of the month by closing the result account;
- The account 6585 „expenses of the site organization", an active account which helps to the discount of the expenses performed for the site organization, through the credit of the third parties accounts, stocks, liquidness, crediting at the end of the month by passing the sums on to the result account.

- encashment of the advance representing the fund for the site organization:

512	=	1678
Bank account		Fund for the site organization

- record of expenses made for the site organization:

6585	=	%
Expenses of the site organization		4xx
		Third parties
		3xx
		Stocks
		5xx
		Liquidness

- at the same time we register the discount of the fund from the site organization incomes:

1678	=	7585
Fund for the site organization		Incomes of the site organization

6. CONCLUSIONS

Like any other economic entity, the organizations in the field constructions may also choose between classic external financing forms (e.g. long- term) and modern ones (bond credit).

Although the bond credit exhibits a series of advantages compared to the long - term loan, the most important being related to the much lower credit costs, the economic entities prefer the long – term loan. We consider that this option is not derived from the complexity of the bond credit, but from traditionalism and fear from the unknown. However, we think that an enhanced promotion of the bond credit would have nothing but positive effects, encouraging the firms to contract such credits.

As shown above, we included in the category of external financing forms for construction firms the funds for the site organisation, as we think that these funds should be presented and accounted separately.

By creating the accounts of the site organization fund we ensure:

- the distinct highlight of the sums enchased from the site organization, being compared with the ones from the object estimate;
- comparison of costs and revenues from the site organization resulting the obtained profit / loss;
- measures to reduce the expenses with the site organization in order to increase the company’s profit.

REFERENCES:

[1]. Dragotă, V.; Ciobanu, A.; Obreja, L.; Dragotă, M. (2003) *Management financiar*, vol. II, Ed. Economică, Bucureşti

[2]. Dragotă, V.; Dragotă, M., et al. (2005) *Abordări practice în finanţele firmei*, Ed. Irecson, Bucureşti

[3]. Feleagă, N.; Ionaşcu, I. (1998) *Tratat de contabilitate financiară*, vol. II, Ed. Economică, Bucureşti

[4]. Nagy, C.M.; Trif, V.; Cotleţ, B. (2010) *Accounting treatments for financing entities,* Annals of the University of Petroşani – Economics, Universitatea din Petroşani,, pp.225-231

[5]. Paraschivescu, M.D.; Radu, F. (2008) *Managementul contabilităţii financiare*, Ed. Tehnopress, Iaşi

[6]. Ristea, M.; Dumitru, C.G.; Ioanăş, C.; Irimescu, A. (2009) *Contabilitatea societăţilor comerciale*, vol. I, Ed. Universitară, Bucureşti

[7]. IFRS (2009) *Official norms issued on 1st January 2009*, Editura CECCAR, Bucureşti

[8]. Law 525/2002 regarding the nominal values and the stock market, updated 2010

[9]. Law 571/2003 corroborated with the Government Decision 44/2004 regarding the fiscal code with application methodological norms, update 2010

[10]. O.G. nr. 51/1997 regarding the leasing operations and companies, updated 01.01.2010

[11]. OMFP 3055/2009 for the approval of accounting norms corresponding to European directives, published in the Romanian Official Gazette, Part I, no. 766 from 10th November 2009