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ACCOUNTING TREATMENTS SPECIFIC TO FINANCIAL ASSETS

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Abstract: *The subject of this article is financial assets, which include securities held in other companies' equity and long-term receivables in the form of long-term loans to other companies or in the form of deposits, guarantees and bail-outs submitted by the entity to third parties. Starting from defining, delimiting and presenting the recognition practices, namely the cancellation of recognition and evaluation of these asset structures, we have exemplified through case studies the accounting of the main financial asset operations.*

Key-words: *securities, shares, deferred green certificates, long-term receivables*

1. Overview

Financial assets, also called long-term financial investments, are a special category of fixed assets, representing a way of placing an entity's cash surplus with another entity whose financial resources are insufficient for its development and which allow the entity that placed the availabilities to earn some financial incomes in the form of dividends and interest or to have benefits by marketing the financial assets.

In the balance sheet, the Order of the Minister of Public Finance no. 1802 / 2014 for the approval of the Accounting Regulations on the individual annual financial statements and consolidated annual financial statements, subsequently amended and supplemented, defines the following categories of financial assets: shares held in affiliated entities, loans granted to affiliated entities, shares held in associates and jointly controlled entities, loans granted to associates and jointly controlled entities, other investments held as property and other loans (Article 264 (1)). At the same time, paragraph (4) of the same article states that in the category of other investments held as immovable assets, the green certificates postponed to payment are also distinctly highlighted.

The significance of the above qualitative structures is presented below:

The shares held in affiliated entities are equity and other variable-income securities held by an entity in the capital of other companies within a group or outside the group,

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subject to the exercise of, where appropriate, sole or joint control, respectively a notable influence. The shares held in affiliated entities may be part of the category of participations, which are rights in the capital of other entities, whether or not represented by certificates, which by creating a lasting relationship with these entities are intended to contribute to the activity of the entity holding those rights. Owning a part of the capital of another entity is an interest in participation if it exceeds a percentage threshold of 20% of the voting rights of the shareholders or its associates.

The shares held in associated entities represent rights in the form of shares or other securities in the capital of associated entities. The associated entity is the one in which the investor has significant influence and is neither a subsidiary, nor a joint venture. The significant influence is the ability to participate in making decisions about the financial and operating policies of the investee without exercising control over those policies. An entity is deemed to exercise significant influence over another entity if it holds at least 20% of the voting rights of the shareholders or its associates.

The shares held in jointly controlled entities represent rights in the form of shares or other securities in the capital of jointly controlled entities. Joint control is shared control over an entity, stipulated by a contract, which exists only when the decisions related to the relevant activities require the unanimous consent of the parties having joint control.

Concerning Equity Titles, OMFP no. 1802 / 2014 specifies at art. 523 par. (1) that if an entity included in the consolidation has associated entities or jointly controlled entities, they are presented as a separate item in the consolidated balance sheet under the item ‘Equity securities’, using the equity method.

In the category of other investments held as assets there are other titles, not the participation ones, titles that the holding entity does not intend or is not able to resell within a relatively short period of time. This category usually includes capital shares and long-term investments.

In the category of financial assets are also included the green certificates whose trading was postponed according to the provisions of Law no. 220/2008 for establishing the system for promoting the production of energy from renewable energy sources, republished, with subsequent amendments and completions.

Finally, long-term receivables include the amounts owed by the subsidiaries for the advances and loans granted by the parent company, long-term loans, interest on long-term receivables and loans granted.

The above presented categories of financial assets are valid only for the entities that apply OMFP no. 1802/2014.

In contrast, for those applying the International Financial Reporting Standards, the IFRS 9 Financial Instruments stipulates the classification of financial assets according to the entity’s business model, removing the categories set out in IAS 39 Financial Instruments – Recognition and Measurement.

Below, we present some aspects regarding the recognition, derecognition and measurement of financial assets according to the national and international accounting references.

Thus, IFRS 9 Financial Instruments stipulates that an entity must recognize financial assets or a financial liability in the statement of financial position only when it is part of the contractual provisions of the instrument. Regarding the cancellation of recognition of a financial asset or its derecognition, the same standard specifies that an entity shall derecognise a financial asset when the contractual rights on the cash flows arising from the financial asset expire.

OMFP no. 1802 / 2014 refers to the measurement of financial assets in two articles. Article 266 specifies that financial assets recognized as assets are measured at the cost of acquisition, and art. 267 stipulates that financial assets are presented on the balance sheet at the entry value less the cumulative value adjustments for impairment.

Taking into consideration the specific nature of this assets category, we consider it is necessary to take into account the following aspects when recognizing and measuring/valuating them:

- the initial recognition must be subject to a credible valuation of the cost of the financial assets. Following the initial valuation, the need for an accounting valuation must also occur when inventorying, presenting items in the balance sheet, as well as when removing assets from the entity;
- in respect of the cost of acquiring long-term securities, it is made up of the purchase price plus the transaction costs directly attributable to their acquisition;
- the long-term receivables should be initially valued at the nominal value equal to the amount of cash receivable;
- subsequent valuation of the inventory – the balance sheet is made at the entry value, less the cumulative adjustments for loss, depreciation or loss of accumulated value;
- if entities measure the financial assets at fair value, the issue of hedge accounting must be retained;
- the valuation at the exit of the financial assets is made at their entry value (in the case of identifiable securities) or at a value calculated using the methods used for goods in the nature of stocks – FIFO, LIFO, CMP or other specific methods (for non-identifiable titles, respectively titles of the same type, issued by the same entity, but with different values). Simultaneously, depreciation or impairment adjustments are reversed to income.

2. Case Studies

We will exemplify, by means of some case studies, the accounting of the main operations regarding financial asset.

Case I. The accounting of the purchased securities must take into account the value immediately and / or later paid and the unpaid portion to be paid to the issuer.

The 'Ʊ' entity acquires from the 'Ɛ' affiliated entity 10,000 shares at the price of 10 lei / share, 70% of the amount being paid by payment order, the rest being paid within 30 days.

– the acquisition of the shares and the initial payment of the amount of 70,000 lei:

261 'Shares held in affiliated entities'	=	%	100,000
		5121 'Accounts with banks in lei'	70,000
		2691'Fee to be paid in respect of the shares held in affiliated entities'	30,000

– next, paying the difference for the purchased shares:

2691 'Fee to be paid in respect of the shares held in affiliated entities'	=	5121 'Accounts with banks in lei'	30,000

- at the end of the financial year, when inventorying, the inventory value of the purchased shares decreased to 9.75 lei / share. An adjustment for the loss of value of the shares held in the affiliated entities is recorded:

6863 'Financial charges for adjustments for impairment of financial assets'	=	2961 'Adjustments for the loss of value of the shares held in affiliated entities'	2,500

Financial charges for adjustments for impairment of financial assets are not deductible from the fiscal point of view according to Law no. 227/2015 on Fiscal Code, art. 26.

After the closing of the first exercise since the shares are held, the affiliated entity 'Ƹ' obtains profit and dividends are due (they are included in the financial income structure) in the amount of 1,000 lei, which is collected via the bank.

– registration of dividends due to 'Ʊ':

461 'Various debtors'	=	7611 'Income from shares held in affiliated entities'	1,000

According to Law no. 227/2015 regarding the Fiscal Code, art. 23 this income is not taxable.

– collecting the dividend value:

5121'Accounts with banks in lei'	=	461 'Various debtors'	1,000

As a result of the reorientation of the financial policy, the 'Ʊ' entity sells the shares held at the affiliated company 'Ƹ' at a selling price of 11 lei / share.

Ceding the securities generates operations relating to the realization of income from the ceded securities, the exit from the entity's assets and, eventually, the commission to a third party or banks.

- sale of shares:

461 'Various debtors'	=	7641 'Income from ceded financial assets'	110,000

- at the same time, the shares are taken out of the record at the acquisition cost:

6641 'Expenditure on ceded financial assets'	=	261 'Shares held in affiliated entities'	100,000

The income generated by the sale of the shares is taxable income, and the expenses generated by the disposal are tax deductible expenses.

By closing these accounts, at the end of the financial year, a gross profit of 11,000 lei generated by the financial investment will be recorded in account 121 'Profit or loss'.

– cashing the value of the sold shares in the bank account of the 'Ʊ' entity:

5121 'Accounts with banks in lei'	=	461 'Various debtors'	110,000

- simultaneously, the adjustment for the loss of value remained without object returns to income:

2961 'Adjustments for the loss of value of the shares held in affiliated entities'	=	7863 'Financial income from adjustments for impairment of financial assets'	2,500

As the costs of the adjustment for the loss of value were not tax deductible, the revenue from the resumption of the adjustment would not be taxable.

Case II. As we have already shown in this paper, in the category of securities of the nature of financial assets the equivalence titles have a special regime. The equity method is the accounting method whereby the investment is initially recognized at cost and subsequently adjusted to the post-acquisition changes in the investor's share of the net assets of the investee. The investor's profit or loss includes its share of the profit or loss of the investee.

The 'ƛ' entity owns shares of the 'χ' associate entity at the acquisition cost of 50,000 lei. The value of the shares was determined by the equivalence method. As a result, on consolidation, they will be recognized as equities, in order to be presented as separate items in the consolidated financial statements.

– recording the recognition of shares held in the associate entity as equity securities:

264 'Titles placed in equivalence'	=	262 'Shares held by associated entities'	50,000

- at the end of the financial year, the 'χ' entity realizes profit, the amount due to the 'ƛ' entity being 1,500 lei:

264 'Titles placed in equivalence'	=	768 'Other financial income'	1,500

If the 'χ' entity had incurred a loss, the share of the 'ƛ' entity in that loss would have been an expense, recorded in the debit account 668 'Other financial expenses', which would have diminished the value of the securities held, too.

Case III. Registration of participation interests as a result of participation in an entity's property (tangible assets) in the capital of another entity.

The 'Ƹ' entity participates in the share capital of a newly established 'Ө' entity with a machine whose value of contribution, determined by expertise, is 100,000 lei. The value of the equipment's registration in the entity's account is 80,000 lei. The machine was acquired 3 years ago and was damped linearly, the duration of use being 5 years.

The depreciation calculated up to the moment of the participation is 48,000 lei (80,000 lei / 5 years x 3 years) and the net book value of the equipment is 32,000 lei (80,000 lei – 48,000 lei).

– removing the machine from administration and receiving shares:

%	=	2131 ‘Technological equipment (machinery, equipment and workstations)’	80,000
265 ‘Other fixed assets’			32,000
2813 ‘Depreciation of facilities and means of transport’			48,000

– recording the securities received whose value exceeds the unamortized value of the equipment up to the limit of 100,000 lei, representing the value of the contribution:

265 ‘Other fixed assets’	=	768 ‘Other financial income’	68,000

Case IV. A distinctive category of patrimonial items is the green certificates. By their economic nature, there are receivables. Depending on the collection term, they may be green certificates assimilated to current assets (less than one year’s collection and are accounted with the help of the account 507 ‘Received green certificates’) and green certificates deferred to payment (collected over a longer period than one year and recognized as financial assets under account 266 ‘Deferred green Certificates’).

The ‘Щ’ entity, which produces electricity from renewable sources, benefits from a monthly quota of green certificates that worth 1,500 lei and at the end of each month it records the revenues generated by the green certificates:

4458 ‘Other received grants’	=	7411 ‘Revenues from operating grants related to the turnover’	1,500

- receiving the green certificates:

507 ‘Received green certificates’	=	4458 ‘Other received grants’	1,500

Highlighting in the accounting the value of the green certificates for which the trading was postponed shall be made on the date of acknowledgment of the right to receive:

266 ‘Deferred green certificates’	=	472 ‘Income recorded in advance’

Upon unblocking the green certificates trading procedure, the entity will make the following entries:

507 ‘Received green certificates’	=	266 ‘Deferred Green Certificates’

and

472 ‘Income recorded in advance’	=	7411 ‘Revenues from operating grants related to the turnover’

Case V. The more significant operations involved in the accounting of the long-term receivables relate to the granting of long-term loans, the related interest, the collection of the loans granted, etc.

On 01.01.N, the 'Ю' entity grants to the 'Я' entity where it holds participation titles a loan in the amount of 100,000 lei for a period of 2 years. The annual interest rate agreed between the two parties is 4% and it is paid in the first month of the next financial year. According to the repayment contract, the full amount will be refunded at the beginning of the N+2 financial year.

– transferring the sum from the account of the 'Ю' entity to that of the 'Я' entity:

2673 'Receivables from associated entities and jointly controlled entities'	=	5121 'Accounts with banks in lei'	100,000

- on 31.12.N the interest due for this year in the amount of 4,000 lei (100,000 lei x 4%) to be collected in January of the year N+1 is recorded:

2674 'Interest on receivables from associated entities and jointly controlled entities'	=	766 'Income from interest'	4,000

The financial income represented by the interest to be collected is recognized as income for the financial year N, although it is collected in the N+1 financial exercise.

– in January N+1 the collection of the interest for year N:

5121 'Accounts with banks in lei'	=	2674 'Interest on receivables from associated entities and jointly controlled entities'	4,000

Similarly, the interest for N+1 is recorded.

– in January N+2 the proceeds of the loan granted and the interest for the year N+1:

5121'Accounts with banks in lei'	=	%	104,000
		2673 'Receivables from associated entities and jointly controlled entities'	100,000
		2674 'Interest on receivables from associated entities and jointly controlled entities'	4,000

If the interests are calculated and collected in the same financial year, it is no longer necessary to use the appropriate receivables sub-account for interest.

Similarly, the other long-term receivables are recorded, such as: advances and payments paid, guarantees lodged with energy, gas, water, sewer, telephone and other receivables.

Loans granted and long-term receivables, which are uncollected for various reasons, are losses and are reflected in the financial expense account 663 'Loss from share-based receivables'.

3. Conclusions

The recognition, measurement and accounting of financial assets are important to ensure the fair, clear and complete image of an entity's assets and the results of its operations.

To recognize these structures as patrimonial items, other related information is often required.

The national accounting reference addresses briefly the issues related to the financial assets, making use of the IAS/IFRS provisions.

Certain elements of financial assets are found only in consolidated accounts, for example, equity securities, and others, such as green certificates, are specific to a small group of economic entities.

The works in the literature dealing with the financial assets look at their recognition and evaluation rather than their accounting.

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