Bulletin of the *Transilvania* University of Braşov • Vol. 3 (52) - 2010
Series V: Economic Sciences

ACCOUNTING APPROACH FOR LONG MANUFACTURING CYCLE ASSETS INTENDED FOR SALE ACCORDING TO THE ORDER 3055/2009

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Abstract: *In the context of efforts of compatibility of existing accounting systems and regulations worldwide, the importance of accounting information and communication language to various beneficiaries is very important. Provision of compliance of accounting regulations with the European Directives in the field is a continuous process that requires adjustment of financial statements to business demands. In this context long term manufacturing cycle assets intended for sale are included in the class of inventories, but "when there is a change of use of tangible assets, meaning that it is to be improved in the light of sale, upon the date of making the decision to change the destination, the accounting registers the transfer of assets from the class of tangible fixed assets to inventories".*

Key words: *long term manufacturing cycle, tangible assets, inventories, transfer, rent, revaluation, sale contracts.*

1. Introduction

According to the "Economic and Financial Dictionary" a long term manufacturing cycle is defined as follows: "in terms of accounting, an asset that necessarily needs a substantial period of time to be ready for use or sale", is a long term manufacturing cycle.

The Order of the Minister of Public Finances no. 1752/2005 for the approval of Accounting Regulations according to European Directives provides that long term manufacturing cycle assets include:

– Inputs under construction (such as buildings, dams, industrial complexes in iron and steel industry)
– Mines under development, special constructions (for instance oil pipeline sections, water supply pipes)
– Certain telecommunication related costs (such as works for preparation of TV broadcasting or satellite networks)

The Official Gazette no. 25 dated January 14, 2008 has published the OMEF no. 2374/2007, amending and supplementing the Order of the Minister of Public Finances no. 1752/2005 for approval of Accounting Regulations according to the European Directives that amend and complete a number of articles, among which those regarding inventories, as follows:

– (10) Paragraph 124, after paragraph (1) inserts a new one, paragraph (2), with the following contents:
– "(2) Inventories include long term manufacturing cycle assets, intended for sale (for instance assemblies or residential complexes, etc)".

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As regards inventory assessment, OMFP states that the "production cost may include the interest on capital borrowed for funding the acquisition, construction or production of long term manufacturing cycle assets to the extent this is related to the production period. If the interest is included in the value of assets, it must be presented in the notes. "Capitalization of borrowing costs must cease when most of activities necessary to prepare the long term manufacturing asset for a predetermined use or sale thereof".

Starting with January 1, 2010 the Order of the Minister of Public Finances no. 3055/2009 for approval of accounting regulations consistent with European Directives is effective. The MFP order no.3055/2009 has two parts:

– Accounting regulations, in accordance with Directive IV of the European Economic Community. These regulations stipulate the format and the content of annual financial statements, the accounting principles and the rules of recognition, evaluation, removal from records and presentation of items in the annual financial statements, the rules for preparation, approval, auditing /verification, by law and publication of annual financial statements and some rules on management accounting, chart of accounts and contents and operation of accounts valid starting with 01.01.2010. Also, these regulation establish rules for the organization and management of accounting and reporting made according to the State Institution requirements for the use by all users;
– Accounting regulations in accordance with Directive VII of European Economic Communities. These regulations stipulate the form and the content of consolidated financial statements and the rules of drafting, approval and publication thereof.

Under item 53 of the Order of the Minister of Public Finances no. 3055/2009:

– (4) "For the purpose of these regulations, long term manufacturing cycle asset means an asset that necessarily takes a substantial period of time to be ready for its predetermined use or sale.

The financial assets and inventories manufactured repetitively over a short period of time are not considered long term manufacturing cycle assets. The assets that upon acquisition are ready for their predetermined use or sale are not long term manufacturing cycle assets, either.

Also, section "Inventories", at item 152 (1) define inventories as current assets, and item 152 (2) states: "Inventories include also long term manufacturing cycle assets intended for sale (e.g. assemblies or residential complexes etc. made by entities that have as main activity obtaining and selling houses). If constructions are made for long term operation by the entity that made the, they are fixed assets".

2. Case Study of Calculation and Accounting of Activities for Acquisition and Sale of Residences

We consider the following cases related to the procurement, operation and sale of real estates in the case of Transilvania SA.

I) The Company decides on independent building of an administrative office consisting of two levels.

1) Purchase of the land on which the construction will be erected from an individual

211 "Freehold land"	=	404 "Suppliers of non-current assets"	27.000

2) Monthly registration of material costs:

a)	601 "Raw material costs"	=	301 "Raw materials"	12.000
b)	6021 "Auxiliary Materials costs"	=	3021 "Auxiliary materials"	37.000
c)	603 "Materials in the form of small inventory'	=	303 "Materials in the form of inventory items"	2.500

3) Monthly registration of expenses, salaries and budgets of social insurances

a) 641 = 421 2.770
"Salaries" "Employees - salaries payable"

b) 6451 = 4311 582
"Company contribution to social security" "Company contribution to social security"

c) 6452 = 4371 14
"Company contribution to unemployment fund" "Employee contribution to unemployment fund"

d) 6453 = 4313 175
"Company contribution to health insurance" "Company contribution to health insurance"

4) Registration of unfinished investments at the end of each month

231 = 722 55.041
"Tangible assets in progress" "Capitalized costs of tangible non-current assets"

5) Final reception and commissioning

212 = 231 560.000
"Buildings" "Tangible assets in progress"

6) The company decides to sell one storey of the building and to keep only the other level as administrative headquarters:

a) Registration of the sale:

461 = % 476.000
"Sundry debtors"
7583 400.000
"Proceeds from disposal of assets and other capital transactions"
4427 76.000
"Output VAT"

b) Removal from records of the part of property sold:

6583 = 212 280.000
"Net value of assets disposed of and other capital transactions" "Buildings"

c) Monthly amortization of the part of property available to the company and used as headquarters

6811 = 212 583
"Amortization of non-current assets" "Buildings"

II) If the company had not made the investment independently and had turned to a contractor, the accounting entries would have been:

1) Monthly records of tangible assets in progress during the development of works carried out by the contractor:

a) 73.780 % = 404
"Suppliers of non-current assets"
62.000 231
"Tangible assets in progress"
11.780 4426
"Input VAT"

b) Commissioning of the investment object

212 = 231 560.000
"Buildings" "Tangible assets in progress"

c) Payment of the debt to the contractor:

404 = 5121 666.400
"Suppliers of non-current assets" "Cash at bank in ron"

III) After the Company Transilvania SA built its administrative headquarters on its own, it decides to build a building consisting of 9 apartments, which will remain the company's property and will be exploited by renting. Three months later, the investment but partly finished, the company receives requests for purchase of flats. Considering that it is advantageous both in terms of market price and in terms of rapid revaluation of the investment, the General Assembly of Shareholders decided the sale of the apartments by changing the investment's destination.

At that time the value of the land, the construction was built on, namely the balance of the account 2111 "Freehold land" is 31.000 lei.

The value of the ongoing investment and recorded in the account 231 was 428.674 lei. The apartments have the same standard finishing and differ only by active surfaces as follows:

Apartments type 1 have the surface of 49 sq.m

Apartments type 2 have the surface of 45 sq.m

Apartments type 3 have the surface of 34 sq.m

To calculate the cost of each we have in mind both the active surface and the common parts, and the value of the associated land as well. Firstly, the cost per square meter of building, namely the cost per square meter of land is determined. Then, depending on the surface of each type of flat, we calculate the cost until the point of work's execution, i.e. cost "partly finished".

Apartments type 1 with active surface of 49 sq.m:

Active surface 49 sq.m * 3 pcs.= 147 sq.m
Common parts 5 sq.m * 3 pcs.= 15 sq.m
Total surface 54 sq.m * 3 pcs.= 162 sq.m

Apartments type 2 with active surface 45 sq.m:

Active surface 45 sq.m * 3 pcs. = 135 sq.m
Common parts 4,58 sq.m *3 pcs.= 13,74 sq.m
Total surface 49,58sq.m*3pcs.=148,74mp

Apartments type 3 with active surface 34 sq.m:

Active surface 34 sq.m* 3 pcs.=102sq.m
Common parts 3,56 sq.m *3 pcs.= 10,68 sq.m
Total surface 37,56 sq.m* 3 pcs.=112,68 sq.m

Cost per square meter of construction 'partly finished' is determined as follows:

<u>Total cost construction partly finished</u>
Total built surface
=428674/(112,68+162+148,74)=428674/423,42=
1012,41 LEI

Cost of each type of apartment:

Apartment type 1
=54mp*1012,41lei/sq.m=55.682,55 lei
Apartment type 2
=49,58sq.m*1012,41lei/sq.m=50.195,29 lei
Apartment type 3
=37,56 sq.m*1012,41lei/sq.m=38.026,12 lei

To this is added the associated land cost:

Total land cost =31.000 lei
Cost apartment type 1 =3691,12 lei
Cost apartment type 2 =3528,14 lei
Cost apartment type 3 =3114,02 lei

As stipulated in the Order of the Minister of Public Finances no. 3055/2009 at paragraph 153(1), when there is a change of use of a tangible asset in the sense that this is going to be subject to sale or improvement for sale, when taking the decision on changing its destination, the accounting department operated the transfer of the asset from the class of tangible assets to inventories. "The transfer is recorded at non-depreciated value of the fixed asset. If the tangible asset has been revalued, along with reclassification of the asset, the revaluation reserve account associated to it is closed."

As regards the lands, the order states that: in case an asset was initially recognized at lands is used subsequently for the construction of residential buildings for sale, the value of the land is included in the value of the asset constructed or is separately highlighted at inventories of the nature of goods, at the accounting entry value. "If the land was revaluated along with the change of the nature of the goods, the reserve account of revaluation thereof is closed".

It results that the transfer of recorded assets as tangible assets has to be made at inventories, as follows:

1) The lands are transferred to raw materials:

a) 2111 = 404 -31.000
"Freehold land" "Suppliers of non-current assets"

b) 301.T = 401 31.000
"Raw materials lands" "Suppliers"

or direct:

c) 301.T = 2111 31.000
"Raw materials lands" "Freehold land"

We have used for lands the analytical 301.T, namely "Raw materials lands".

2) The building is transferred to the class of inventories, i.e. finished products:

a) 231 = 722 - 428.674
"Tangible assets in progress" "Capitalized costs of tangible non-current assets

b) 331 = 711 428.674
"Goods in progress" "Revenues associated with the costs of the completed production"

c) 345.I1` = 331 428.674
"Finished goods" "Goods in progress"

3) The sale is recorded based on preliminary agreement of three apartments, one of each type, partly finished based on advance invoice:

Apartment type 1

a) 4111 = % 65.468,5
"Customers" 419 62.351
"Advance payments from customers"
4427 3.117,5
"Output VAT"

Apartment type 2

b) 4111=% 70.076
"Customers"419 66.739
"Advance payments from customers"
4427 3.337
"Output VAT"

Apartment type 3

c) 4111=% 55.094
"Customers"419 46.297,5
"Advance payments from customers"
4427 8.796,5
"Output VAT"

4) We record on a monthly basis the finishing works of building 1 for which we have created the analytical 345.I1

a) 331=711 12.500
"Goods with in progress" "Revenues associated the costs of completed production"

b) 345.I1=331 12.500
"Finished goods" "Goods in progress"

One of the buyers, besides standard finishing wants certain additional equipment for which we have created a separate analytical 345.S.I1 and records will be:

a) 331=711 8.403
"Goods in progress" "Revenues associated with the costs of completed production"

b) 345.I1=331 8.403
"Finished goods" "Goods in progress"

5) The property is finished and the sale of the three apartments is done under contract, by reversal of advance invoices and issuance of final invoices:

a) 4111 = % -65.468,5
"Customers" 419 - 62.351
"Advance payments from customers"
4427 -3.117,5
"Output VAT"

b) 4111 = % -70.076
"Customers" 419 -66.739
"Advance payments from customers"
4427 3.337
"Output VAT"

c) 4111 = % -55.094
"Customers" 419 -46.297,5
"Advance payments from customers"
4427 -8.796,5
"Output VAT"

6) Apartments type 1:

Final standard value = 65.587,86
Improved value = 0
Land value = 3.691
TOTAL COST = 69.278,86
Selling price VAT free = 124.702
VAT 5 % (first house) = 6.235

Sale:

a) 4111 = % 130.702
"Customers" 701 124.702
"Sales of Finished goods"
4427 6.235
"Output VAT"

Inventory reduction:

b) 601 = 301.T 3.691
"Raw materials" "Raw materials"
711 = 345.I1 65.587,86
"Revenues associated with the costs of completed production" "Finished goods"

7) Apartments type 2:

Final standard value = 60.219,37
Improved value = 8.403
Land value = 3.528,14
TOTAL COST = 72.150,51
Price of saleVAT free = 133.478
VAT 5 % (first house) = 6.674

Sale:
a) 4111 = % 140.152
"Customers" 701 133.478
"Sales of finished goods"
4427 6.674
"Output VAT"
Inventory reduction:
b) 601 = 301.T 3.528,14
"Raw material costs" "Raw materials"
711 = 345.I1 60.219,37
"Revenues associated with the costs of completed production" "Finished goods"
711 = 345.S.I1 8.403
"Revenues associated with the costs of completed production" "Finished goods"

8) Apartments type 3:

Final standard value	=	45.620
Improved value	=	0
Land value	=	3.114,02
TOTAL COST	=	48.734,02
Sale price VAT free	=	92.595
VAT 19%	=	17.593

Sale:
a) 4111 = % 110.188
"Customers" 701 92.595
"Sales of finished goods"
4427 17.593
"Output VAT"
Inventory reduction:
b) 601 = 301.T3. 3.114,02
"Raw material costs" "Raw materials"
711 = 345.I1 45.620
"Revenues associated with the costs of completed production" "Finished goods"

3. Conclusions

Examining this kind of recording of assets acquired by entities that have engaged in obtaining and selling homes, we see that they comply with accounting rules that require entities to distinguish between current assets and fixed assets. If the building in question had remained available for rent, it would have been a fixed asset, while assets classified as property for sale fail to meet the conditions for being classified as fixed assets, being part of current assets. Also, analyzing the structure of expenditure and revenue resulting from these records, we see that:

– Revenues from sale of residence considered stocks are included in turnover, which ensures an accurate reflection thereof in the profit and loss account
– Revenues and costs associated with activity of sales of property have auxiliary nature being classified as "other operating income" and "other operating expenses"

Provision of compliance of accounting regulations with European directives in the field is a continuous process that requires adjustment of financial statements to business demands and various categories of users of the accounting information, a process that our country is dynamically crossing in recent years especially along with the European Union accession.

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