ACCOUNT INSTRUMENT CAPITAL BORROWED

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***Abstract**: Setting up business capital is made from different sources and their use coordinates its policy aims, issues that affect the overall efficiency and thus differentiate companies with the same profile of activity and a similar level of capital advanced in the economic cycle. Thus financial structure, the average cost of capital used in the mechanism how the financial management of the company, of particular importance for this.*

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Own sources of financing available to firms may be insufficient to cover the financing needs of global enterprise, or less profitable so that resort to other means: the issue of bonds, bank loans and long term, supplier credit, and other operating debt. Overall capital from medium and long term debt is to finance fixed assets, and those from short-term debt to finance temporary needs. Short-term debt has advantages and limitations: short-term loans granted by banks quickly, offering flexibility in financing the company, but may expose the company to the risk of insolvency, when it is forced to repay large amounts similar terms. Medium and long term debt through bank loans are made for a period exceeding one year, based on collateral (mortgage, pledge, assignment of claims, assignment of rights to compensation of insurance, letter of guarantee issued by banks or financial institutions in the country or abroad) and a robust economic and technical documentation.

In an environment without tax, the interest rate paid on loans contracted is the cost of borrowed capital.

Selecting means, techniques and financial instruments is putting into practice concrete expression of a financial policy which consists in determining the weight they have and must have equity and debt the company's resources, taking into account their actual cost (remuneration claimed total contribution of funds). Using borrowed capital can increase profits by shareholders, but also involves increased risk associated with the company. Use of borrowed resources presents a number of advantages for maintaining an optimal ratio between equity and borrowed. First, the cost of equity is generally lower than equity loan when the rate of capital cost is less than the rate of economic return. This advantage is added, a series of arguments about the motivation of managers, reduce the risk of reinvestment, strategic and operational efficiency. In the literature on financial management of the company stated strongly that a high debt motivates managers to streamline activities in the interest of shareholders.

Reduce investment risk is observed due to the binding nature of the payment of debt service, when used borrowed capital, making the amount to remain available to the manager is lower[1]. If not, the financial resources would be very high, there may be a risk that without the existence of investment opportunities with positive net value, providing investing the entire amount available, the manager to invest these resources in unprofitable projects.

This danger is very high in firms with high profits but these have limited investment alternatives. Annual surplus cash flow is, in this case, placed for purchase of company value growth opportunities, which often costs more than worth.

Operational issues and strategic effectiveness are difficult to solve in a capital case based primarily on equity. Managers of companies with high leverage are more aware of the danger of falling efficiency and profitability, although they have the same effect as if a company with greater financial autonomy and dependence for its external funding. In the latter case, the debt service obligation debt, the situation seems more serious, managers can not allow losing activities because they are pressured by the obligation to make periodic payments on the debt account who hired her. While theoretical arguments are, in practice it may be noted that excessive levels of debt has a positive effect on business. A large volume of loans can prevent the company to meet its debt service in years in which they work is not very profitable. Under these conditions there is a risk of bankruptcy risk increases with leverage. In general, financial consolidated companies are able to use large amounts of borrowed funds because of a steady stream of profit, enough to interest payment and capital repayment loan.

[1] Ristea M., Dumitru CG - Advanced Accounting, University Publishing House, Bucharest, 2005

In contrast, it appears that small companies, which in principle should not rely on borrowed capital, use of this alternative, or the desire to develop urgent material basis of results in production or in overcoming the idea of equity gaps, but are guaranteed immediate positive results to be covered.

Debt strategy decision that marks the company in this field arises due to the resulting inequality between self-financing and net borrowing and taking into account any subterfuge to avoid the use of the path that is financial coverage by increasing capital or leasing employment (figure . 1.)

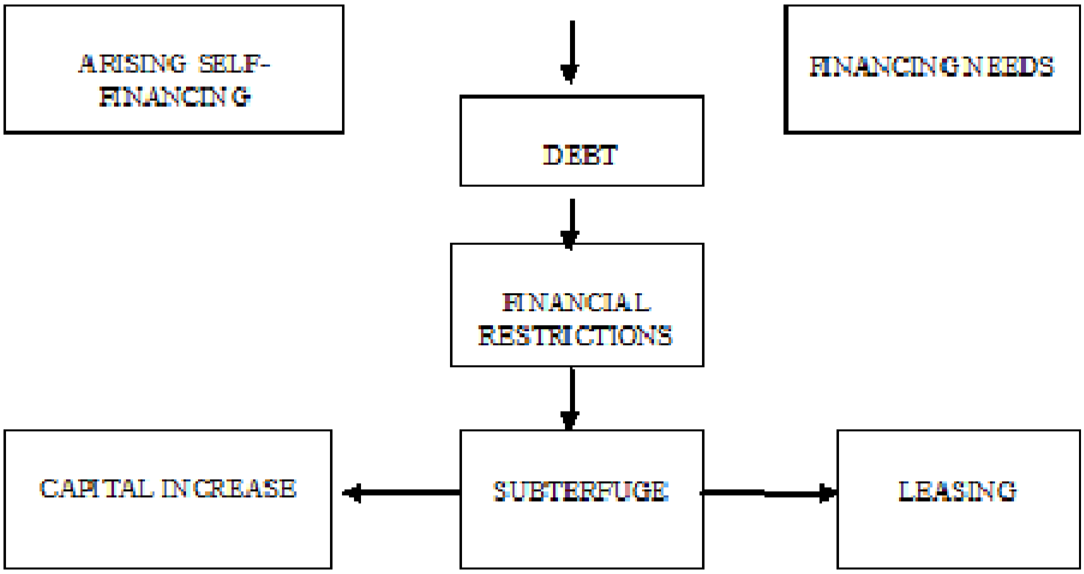

Fig. nr.1. Medium and long term debt

It aims to provide business with permanent capital, which gives them the possibility of adopting a strategy of development and functioning in a relatively long time. Some assets require a long time to be ready for use or sale. The company will have to borrow to finance long-term production of these assets. Management will need to know if the interest on these loans are recorded as expenses immediately or will be capitalized (to be considered as an element of cost of acquisition or production, if necessary, the asset financed by borrowing). Under the allowed alternative treatment, borrowing costs are considered as an element of cost of acquisition or production, as appropriate, of the asset, and by their nature are different from other expenses to be capitalized frequently. Assets targeted are those that require substantial time to get ready, before being used or sold. Capitalisation of borrowing costs is achieved only if it is possible to generate future economic benefits and costs can be determined reliably.

Capitalisation of borrowing costs[2] is possible when the establishment of property which require a long manufacturing time. It also is possible to capitalize borrowing costs and the production of stocks requires a substantial period to reduce them to a stage that can be sold. Instead, do not qualify for capitalization at the time of purchase those assets that are ready for use which are intended or sale, that those assets which are manufactured by outdated procedures or products in large quantities on a repetitive basis in a short period.

Opponents argue that such a practice capitalization would result in a different valuation of an asset, depending on the mode of funding, as it is a loan or a grant of funding recourse to equity. The exception would be the situation that would allow a good incorporation into the cost of equity remuneration, to which no solution specialist achesează not where financial accounting work. The existence of alternative treatment was often discussed by normalization accounting bodies. Fourth European Directive allows, but not required, to require inclusion of borrowed capital interest in the cost of production. Article 39 states: "Including the cost of recovery of interest on capital borrowed to finance the production of property is permitted to the extent that interest covers the period of manufacture[3]". In this case, entry into active interest must be reported in an annex to the balance sheet. Identification of loans that can be capitalized is easier or more difficult depending on how the asset financed:

- Through special borrowing to finance long-term asset
- The financing of long-term assets not subject to special lending (loans company, other than those made specifically to get a long-term assets).

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[2] Ristea M., L. Olimid, Calu YES - comparable accounting systems, CECCAR House, Bucharest, 2006

[3] A. Pop - Romanian financial accounting harmonized with the European accounting directives and Inter ¬ national accounting standards, Intelcredo House, Deva, 2002

If the borrowing is intended to have a particularly long-term assets, borrowing costs should be incorporated in the cost of the asset by reducing their income from reinvestment of borrowed funds, before using these funds to make payments to obtain term assets long.

IAS 32 "Financial Instruments: Presentation" not only restrict borrowing costs capitalized costs of special-purpose loans. If the funds for lending contracts with general are potentially used to finance a qualifying asset production, the amount of debt costs that can be capitalized is determined by weight at a rate of capital asset representing the weighted average cost borrowing the applicable loan company, other than those incurred to obtain a specific qualifying asset production.

Where the alternative treatment, the capitalization of borrowing costs may begin when the acquisition costs, production of long-term assets begin to be generated and incorporated termination occurs when the asset is ready to be used or sold, are needed even though routine administrative work. Where is suspended for a period asset construction or production is suspended properly and capitalized financing costs during a period in which important technical and administrative work or during a break is a necessary part the process of bringing an asset able to be used or sold. In accounting for borrowing costs, IAS 32 provides two methods: capitalization method and the method result.

If the enterprise has an interest:

- To increase the profit or loss, it will apply the allowed alternative treatment of IAS 32 "Financial Instruments: Presentation ', that is to capitalize borrowing costs, avoiding evidence of expenses;

Scope of IAS 32 "Financial Instruments: Presentation":

- Defines financial instruments;
- Formalize the requirements for the presentation of financial instruments.

a) Definitions:

A financial asset is an asset that is:

- Treasury;
- A contractual right to receive from another entity elements of cash or another financial asset;
- A contractual right to exchange financial instruments on potentially favorable terms;
- An equity instrument of an entity.

A financial instrument is a contract that gives rise to both a financial asset of one enterprise and a financial liability or an equity instrument (the) other companies.

A financial asset is an asset that belongs to the treasury, a contractual right to receive from another company cash items or another financial asset, or a contractual right to exchange financial instruments with another enterprise under conditions potentially favorable.

Also, a financial asset may be an equity instrument of another enterprise. An equity instrument is a contract that outlines a residual interest in assets of a company after deducting all liabilities (debt).

The issuer of a compound financial instrument that contains both a liability and an equity element should classify the various components of the instrument separately.

An issuer's financial position should be played by separate presentation, the nature of the liability component and equity of a single instrument composed.

Often, companies repurchase their own shares. These actions should not be given the asset side, but deducted from equity. In addition, gains or losses arising from the purchase, sale, issue or cancellation of own equity instruments, will be recognized in profit or loss. Any discrepancy found between the conversion price and the sale or purchase price of its shares will be recognized directly in equity.

b) Presentation:

The issuer of a financial instrument classified various instruments based on its components, as defined IAS 32 "Financial Instruments: Presentation ', depending on the economic reality of the agreement.

The issuer of a compound financial instrument "debt and equity" determine the value of the debt component taken in isolation, the equity component obtained in this case, the difference in the size issue.

When an entity holds own shares are deducted from equity. Any gain or loss found (a) when a transaction on an entity's own shares is accounted for in equity, not results.

- To reduce the profit or loss, it will apply basic accounting treatment prescribed by IAS 23 "Borrowing Costs", which is the record borrowing costs as an expense in the period in which they appeared.

Standard IAS 23 "Borrowing Costs" generally treats borrowing costs and shift them to the cost of certain qualifying asset production.

Standard accounting rule requires all borrowing costs in charges for the year in which they were engaged. Exception is made for borrowing costs directly attributable however the acquisition, construction or production of a qualified asset. A qualified asset is the asset that requires a long period of training before they can be used or sold, such as property or stocks with long production cycle.

Incorporating the cost of borrowing costs related activities should commence when:

- Expenses related to the activities were carried out;
- Borrowing costs are incurred, and
- Activities essential to preparing the asset, prior use or sale have been started.

Capitalisation should be suspended during the development of qualified asset is stopped. Capitalization should cease when most activities necessary to prepare the asset qualified for its final use, ended.

To the extent that funds are borrowed specifically for obtaining a qualified active, the size of borrowing costs in the cost of the asset corresponds Built actual expenditure incurred on these loans during the year due to any income derived from temporary classification of these borrowed funds. Conversely, if funds are borrowed Widespread Built size borrowing costs in the cost of the asset must be determined by applying a capitalization rate to the cost of the asset.

The capitalization rate should be the weighted average borrowing costs applicable to loans under the entity, on behalf of the exercise, other than special loans in order to obtain the asset concerned. Size embedded in the cost of borrowing costs during a given financial year assets must not exceed the total size of borrowing costs incurred during the same exercise.

The information provided relates to:

- Accounting policies adopted for accounting for borrowing costs;
- The amount capitalized, and, if applicable
- Capitalization rate used.

Borrowing costs include interest and other costs incurred by the company in connection with loan funds. Thus, borrowing costs may include:

- Appropriate interest overdrafts;
- Short and long term loans;
- Amortization of repayment of loans;
- Additional depreciation expenses made in order to obtain loans;
- financing costs related to financial leases;
- exchange differences on loans in foreign currency if they are seen as an adjustment to interest expense.

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