

# **SUBSIDIES ACCOUNTING – BASIC INSTRUMENT IN IMPROVING ENTITIES' PERFORMANCES**

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## **Abstract:**

Subsidy is an important instrument in achieving economic and social objectives and it must be considered a short term necessity that has to respect the ensemble interests of the economy, the producers and consumers' interests and not to entail the state budget.

A thorough analysis of the financing possibilities (subsidy) is important for any entity, but the choice has to be made based on the recommendation of the domain specialists. No price is too high if it ensures you business continuity.

**Key words:** financing methods, subsidy, investment subsidies, operating subsidies

## **1. INTRODUCTION**

In the present context, capital represents the main production factor, business development is practically impossible without considering the financial market and the resources that it offers to the economic agents. The main actors in the financial system are the state, the economic agents and population. While the population is interested in investing its incomes, the economic agents are focused in attracting as much as possible these resources in order to finance the unfolding and the development of their business.

In essence, the financial systems' evolution has also determined the evolution of the financing methods for enterprises, from a self- financing system to a direct financing system (without intermediaries) and then at the intermediary financial system. As a matter of fact, these three financing methods reflect exactly the ensemble evolution of the financial system.

**Financing** is the entities' option destined for obtaining funds (liquidity) in order to cover temporary needs generated by commercial or production activities, or for

development the existent production capacity through unfolding investments projects. Financing decision means choosing between personal funds and external fund for an investment project, and most part of the financial resources come from private sources (commercial banks, investment banks, investment funds), public sources usually occur in financing some important investment project and of general interest (investment in transport substructure).

## 2. FINANCING METHODS

The main financing methods used by entities are the following:

- ❖ self- financing (internal financing) – accomplished by using exclusively the positive financial results obtained in the previous budgetary years;
- ❖ resorting to external personal capitals – accomplished by increasing cash capitals or by contribution of capital;
- ❖ resorting to long term, middle term or short term credits, accomplished by bonds emission or by resorting to specialised credit institutions.

For a more analytic classification of the financing resources other five criteria can be used. These are: the nature of the debentures determined by the financial operations, the operations' term, the origin of the used funds, the nature of the funds' use or destination, reimbursement manner.

From my point of view, the best classification is the one **regarding the reimbursement manner**. From this point of view, we distinguish two types of financial resources: reimbursable financial resources and unredeemable financial resources.

Accessing unredeemable funds is a reality of the last years. More companies direct themselves towards these funds in order to accomplish the development objectives.

**Reimbursable financial resources** consist in the enterprises' obligatory character to repay at a certain term the loaned sum in the depreciable way in equal or unequal instalments at different terms or unredeemable, if the reimbursement of the loaned sources is made entirely at a single term. Usually, in this category of financial resources there are: bank loans, bonds, bank acceptance, commerce effects, as well as salaries and taxes and commercial credits. **Unredeemable financial resources**

include, firstly, the resources resulted from self- financing, but also the ones resulted from the increased personal capital. In addition to these, but not least as importance, even though they don't have conjectural character, there are "support finances", generally with "oriented" character, promoted by national or international governments or nongovernmental organisms. The record in accounting of the receiving or usage of these unredeemable funds is made in conformity with the *provisions of the public finances minister's order no. 3055/ 2009*. According to these regulations the **unredeemable funds** are registered in the **subsidies** category.

### **3. SUBSIDIES – PROCEEDINGS AND POLICIES**

The state intervenes in forming the prices in the unproductive economies, in which the macroeconomic stability is affected by the economic branch structures. The state influences the price mechanism through the fact that, in case of an important lack of balance between demand and supply, it creates a "fare price" that is favourable for the producer, as well as for the consumer. The most familiar form of the state's intervention in economy is represented by **subsidies**.

"**Subsidy** is a complex and coherent system of measures and practical methods used with the purpose of stimulating economic growth and defending national interests and the interests of the autochthonous economic agents"<sup>1</sup>. One of the subsidy methods is subvention. This "represents a monetary support, unredeemable, provided by the state to an economic agent, with the purpose of covering part of the expenses"<sup>2</sup>. Subsidy is a method contested by the followers of the free trade. Nevertheless, it is necessary as a means of orientation, adjustment and incentive of some productions or of protection of the producers and consumers.

Subsidies are granted by the state in order to encourage branches and sub-branches of great interest for a countries' economy. Subsidies are mainly oriented towards agriculture due to the importance of this branch in the macroeconomic balance and for ensuring food security.

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<sup>1</sup> Gorincu, Gheorghe; Nechita, Vasile-"Economia de piata"; ed. Danubius, Braila, 1993, p. 8

<sup>2</sup> ditto

**Accounting policies** are established by the entities that request subsidy, based on the subsidies' type and the legal terms for granting it. Another criterion which is taken into consideration in establishing accounting policies is the compliance with the accounting principles. The most applied principle is the **prevalence principle** of the economic against the juridical. This principle is carried out by the fact that there can be established accounting policies that stipulate the subsidy registering in accounting to be made at the date when the application for granting the subsidy is made, considering that the entity meets the legal conditions, this being a fact situation, following that at the approval of the subsidy to appear the situation by right, to receive the subsidy. Also the **principle of exercises' independence** has to be respected and enforced. We meet difficulties in enforcing this principle at the subsidies for incomes; from which part are destined for covering some identified direct expenses. It is known the fact that the activity in agriculture has a specific character, due to seasons, cyclical effect, and most times a difference of time occurs between the period in which expenses are collected and the period when the actual incomes are achieved.

Subsidy is carried out under different form and it can be debated depending on several criteria.

a) ***Regarding the manner that the expenses are made, the manner that the budgetary funds are allocated, subsidies can be: direct and indirect.*** *Direct subsidy* takes into consideration the transfer of sums that represent the difference between the market price and the production cost (higher), or in the case of exports the difference between the higher internal cost of export and the world-wide one that is reduced, from the state's account in the economic agents' account. *Indirect subsidy* can consist in: - measures for fiscal policy (reduction or exemption of duties and taxes); - production stocking for establishing the prices; - supply of raw materials; - means of production in more favourable conditions; - low costs for supply and storage; - credit financing; - ensuring and providing lending; - insurance programmes against the rising cost of production or cost of risk arising from foreign exchange variation; - facilities in the information area;

- b) - specialized technical and economic assistance; - conducting market research, etc.
- c) ***Depending on destination, subsidies can be: subsidies for income support and subsidies to support costs.*** *Income subsidy* is differently accomplished depending on the recipient: the producer or the consumer, and naturally its effects are different. Therefore we distinguish: producer subsidy and consumer subsidy. *Cost subsidy* refers to subsidies for production factors. This refers to: - investment and modernization in productive purpose; - procuring machines and equipments; - professional training; specialty assistance; - supply and transport services free or with reduced taxes. Through producers' income subsidies and of the production factors, it is intended to increase or even maintain the production at a minimum level.
- d) ***For the purpose in which they are used,*** subsidies can be: ***subsidies for increasing production*** (through supporting producers and the production factors), ***for limiting production for the surplus products***, as structural and specialising production instrument, for protecting the consumers' interests and harmonising them with the producers' interests, in order to increase the usage degree of workforce, for protecting the rural areas and stabilising population, ***for the development of certain areas***, in order to achieve the ecological function of agriculture.
- e) ***Regarding the sustained commercial flow,*** subsidies can be:
- ❖ *Subsidies for internal production* consider the increase of the production until the equilibrium limit of the internal supply and demand is achieved.
  - ❖ *Subsidies for import* are not used often and they are used in direct imports made by the state and sold at loss, in pursuing the growth of supply, reducing and stabilising internal prices.
  - ❖ *Subsidies granted for export.* It's pursued commercialization on external markets of some products of a strategic importance for ensuring the commercial balance, achieving some social objectives and economy development.
- f) ***In accounting terms,*** according to **IAS 20 "Accounting for Government Grants"** it is known that subsidies are classified in two categories:

- ❖ *subsidies adherent to assets* (**investment subsidies** for which in order to receive them an entity should buy or build assets);
- ❖ *subsidies adherent to incomes* (operating subsidies, other than the ones regarding assets). These have to be included in the result for the year from the moment they become demandable, and so we can register them at incomes, or we can deduct them from the corresponding expenditures.

Namely, subsidies related to *depreciable assets* are recognized over the time as incomes also in the proportion in which the depreciation of these assets is recognized. This type of subsidies are registered in the balance sheet as investment subsidies and they are recognized in the profit and loss account as the depreciation expenses are registered or at the discarding or disposal of the assets acquired from the respective subsidy.

It is specific for subsidies the fact that, due to their irredeemable character, they should be recognized as incomes. Attaching these incomes to different periods of annual revenue depends of the nature of subsidies.

Government subsidies are sometimes designated in other ways, such as: *subventions, donations (benefits) or rewards*.

According to MPFO 3055/ 2009 both properly subsidies, as well as funds with irredeemable character are registered in their entry in the entity's assets as components of sole capital using the account **445 "Subsidies"**, account that keeps track of settlements regarding **subsidies related to assets** and those related to incomes, distinctly on state subsidies, irredeemable loans in the form of subsidies and other amounts received in the firm of subsidies.

According to article 237 from MPFO 3055/ 2009 subsidies related to assets, including non-monetary subsidies at fair value are considered subsidies for investments and are avouched in the balance sheet as a deferred income using the account **475 "Investment subsidies"**, account that keeps track of state **investment subsidies**, irredeemable loans with a character of investment subsidies, investment donations, inventory additions such as tangibles and of other received sums received with a character of investment subsidies and it contains the following analytical

accounts: Account **4751** – Governmental investment subsidies, Account **4752** – Non-repayable loans in the form of investment subsidies, Account **4753** – Investment donations, Account **4754** – Inventory surpluses in the form of non-current assets, Account **4758** – Other amounts received in the form of investment subsidies.

## **CONCLUSIONS**

Being considered important means for achieving objectives of economic and social policy, subsidies should be considered a short term necessity, a transitory measure until the functioning market mechanism, respectively the free balance of supply and global demand won't have disruptive effects, affecting the maximization principle of useful effects for the participants in the economic exchange: producers and consumer, respectively exporters and importers. It must be the ensemble interests of the economy, the producers and the consumers' interests and not to affect very much the states' budget.

If subsidy maintains at a long term there is the risk to ensure an artificial competitiveness of some unprofitable products, to delay structural production adjustments depending on the demands' evolution, of affecting the states' budget without obtaining an increase of efficiency and competitiveness of the national economy.

The most important aspect that we should consider in the case of these subsidies is the recognition of the incomes generated by their reception in the same administration exercise (usually the month according to calendar) in which we recognize the operating costs that these subsidies will cover. *If the subsidy is covered in a previous exercise* of income recognition, this can be registered as income recorded in advance or delayed income. *In the case that the receipt of the subsidy is subsequent* to the appearance of the expense, respectively of the income, in order to register income it is used, in counterpart, the debenture account 445 "Subsidies", aims to lavish subsidies to support investments.

In accordance with legal provisions, autonomous administrations, national companies, state owned companies and public institutions that provide services for local governments can receive from the budget subsidies and price differences. These

are granted to recipient units through ministries on budget credits open in this respect.

In the future it is followed that state enterprises that register losses to receive less subsidies from the government to motivate the directors of these enterprises to elaborate concrete plans to streamline the activities. A disadvantage of state subsidies granted to state companies is the fact that this way the economy is negatively influenced by the state, affecting competitiveness between private and state sector.

In conclusion, we can say, that for a right appliance of the accounting policies regarding subsidies it is necessary firstly the existence of a manual of accounting policies and procedures within each entity from the agriculture and industry domain, for all the performed operation, starting form the drafting documents in proof until the completion of quarterly and annual financial statements, as well as informing the personnel from the financial-accounting department regarding the subsidies granting procedure. Only by the collaboration of all departments within an entity to enforce all the implemented procedures, it can be reached a reasonable overview of subsidies in accounting and finally in the financial statements of entities.

These procedures must be developed considering the specific of the activity by specialists in the economic, technical and commercial domain, experienced in the activity carried out and of the strategy adopted by the corporate body.

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