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Financial Accounting Interferences which Affect the *Authentic* Image of the Results and Performances of the Private Companies from the Construction Industry

Emil Chirila

University of Oradea, Borsului nr.7, Oradea, 0723225220

Email: director@crisanacons.ro

Abstract

The ascending trend of the economy stimulated the rise of the volumes of the construction activities. In the condition of prognosed increase of investments, based on public funds and grants, it's needed perfecting the financial mechanisms which should assure the selection of the most competent companies for awarding the tender procedures on the constructions works.

The accounting synthesis documents (balance sheet, profit and loss account), as instruments for reflection of the performances have the task of ensuring an authentic image of the actives, of the results and of the financial capacity of the bidders. The way of reflecting some accounting and financial operations like the good execution warrantee, formed from retains from the revenues realized by the contractors, repartition of the results at the end of the financial years; have direct implications in the distortion of the results at the end of the financial years and distortion of the information regarding the financing capacity of the bidders.

As well, the modifications brought to the Fiscal Code, starting from 2007 according to regulation of the VAT by introduction of the "inverse tax" and of the payment approach of the income tax, starting from 2008, will have negative effects over the financial liquidity and over the capacity of financing.

The positive evolution of the national economy with an yearly growth rate of about 8% in 2006 influenced favorably the construction market as well, which witnessed a growth rate of 19.3% compared to 2005, reaching the level of 7 billion euros in 2006, holding a 10% share of the GDP and with an estimation of growth to 12%, in the medium period.

- As factors with positive influences can be mentioned the following:
- Increased volume of foreign investments;
- Substantial funds from pre-aderation programs and important amounts of credit from international organisms;
- Increased budgetary allocations;

- Increase of the private funds in investments.

As well were factors which had a negative influence from which we are mentioning:

- The slow alignment of the public procurement legislation to the European directives;
- The crisis of the work force, especially of the qualified one, amplified by the departures for working abroad and by the weakening of the professional and technical-engineering education;
- The large share of the black(illegal) economy;
- The excessive taxation, in general and especially of the work force, with consequences in amplifying the illegal labor.

The authentic image constitutes a criteria of performance of the modern accounting in the way it ensures a realistic reflection of the reality, by a complete and pertinent information over the economic processes expressed in monetary standard, fact which imposes respect with “good will” of the rules for the evaluation of the patrimony, and of the rules and principles of accounting. The annual financial reports must offer a clear image of the actives, debts, financial position, profit or loss for the organization.

For companies from the construction industry, the financial reports represent a significant importance, being the main source of information for determining the indicators of solvency and of financial capacity for sustaining adjudication of future works and services, according to the actual legal regulations.

For the effectuation of public procurement of services and works, the contracting authority is requiring from the bidders to make offers for the award of the contract.

From each tendering procedure of a contract any candidate/bidder can be excluded if it's not eligible, respectively if it's in bankruptcy or in procedure of liquidation, for the candidates which didn't paid taxes towards the state, or the contribution towards the state social insurance.

For the verification of the economical – financial capacity of the candidates/bidders, the contracting authority has the right to ask them the financial statement and other relevant documents which prove the economical-financial capacity; like, letters of credit from the banks, situations regarding the global revenues, confirmation of detaining of insurance policies for different professional risks.

The contracting authority has the right to establish, as minimum requirement, framing of the value of some financial indicators over a minimum imposed value, like:

- a) The average annual revenue over the last 3 years, equal or larger than a minimum value imposed which can not overpass the estimated annual revenue of the work contract, which must be awarded, multiplied by 3.

- b) General liquidity (circulating assets/current debts x 100): minimum requirement – framing of the value of this indicator over the percentage of 100%, but just in the case in which fulfillment of the contract must be realized in a period larger than 3 months.
- c) Patrimonial solvability (own capital /total passives x 100): minimum requirement - framing of the value of this indicator over the percentage of 100%, but just in the case in which fulfillment of the contract must be realized in a period larger than 3 months.
- d) Financial capacity of the candidate/bidder to sustain the execution of the contract.

The candidate must prove that it has access or has available real and not affected by debts resources, lines of credit confirmed by banks or other financial means enough to realize the cash flow for the execution of the work within the imposed period.

$C(f) = (v(r) \times F(r) - Vlce) + Lcn + Dp$, in which:

$v(r)$ - represents the annual speed of rotation for the circulating fund and its calculated like this:

revenues from the exploitation resulted from the balance sheet of the last closed financial year

The circulating fund calculated based on the data from the balance sheet of the previous closed financial year

$F(r)$ - represents the circulating fund calculated on the basis of the data from the balance sheet of the last closed financial year and is calculated as the following:

Circulating Actives - Current debts (debts of which term of eligibility is under 1 year)

$Vlce$ - represents the actualized value of the works remaining to be executed, at the date of the presentation of the documents which prove the economic-financial capacity, for the following 12 months

Lcn - represents the line of credit not-consumed at the date of presentation of the documents which prove the economic-financial capacity, confirmed by the bank

Dp - represents bank deposits at the date of presentation of the documents which prove the economic-financial capacity, confirmed by the bank.

The financial analysis has a succession of disadvantages: the existing information is static and is referring to data from the past, or previous performance not constitutes a warrantee of the future performance.

The obtained information is representing just the starting point in evaluation of a business.

For the construction works, the law stipulates the possibility to create a warrantee of good execution by issuance of a letter of guarantee and retains of 5-10% from the realized revenues.

In the situation in which the execution of works it's extending over the several financial years, the warrantees retained and freed later contribute to the distortion of results and are affecting the clear image of the results reflected by the annual financial reports.

The Fiscal Code, in the article 22, stipulates the possibility of constituting provisions for the good execution warrantees, ensuring deductibility of the costs. As an example, in the table number 1, we present the results regarding three financial exercises (years) within a construction company in which were retains for the good execution warrantees and which were canceled at the end of the last financial exercise (year), following the final reception of the objective of investment by the beneficiary.

Table 1

| | 2004 | 2005 | 2006 |
|-------------------------------------|----------------|----------------|----------------|
| Production of the exercise | 20981025 | 20957447 | 13659575 |
| External material expenditures | 16793770 | 17112025 | 9906841 |
| Added Value | 4187255 | 3845422 | 3752734 |
| Human resources Expenditures | 993802 | 1406871 | 1037833 |
| Taxes | 37329 | 37387 | 60935 |
| EBE | 3156124 | 2401164 | 2653966 |
| Revenue from provisions | 0 | 0 | 737661 |
| Expenses with amortishments | 247668 | 305001 | 346220 |
| Expenses with calculated provisions | 337544 | 380152 | 241905 |
| PROFIT FROM EXPLOITATION | 2570912 | 1716011 | 2803502 |
| Financial Revenues | 217654 | 372939 | 176317 |
| Financial Expense | 70648 | 108021 | 46913 |
| RAW PROFIT | 2717918 | 1980929 | 2932906 |
| Tax on profit | 657936 | 299331 | 437681 |
| NET PROFIT | 2059982 | 1681598 | 2495225 |

The harmonized accounting regulations with the European directives, within the article 186, let. c, are stipulating the possibility to constitute provisions for taxes, for future amounts of money to be paid, owned to the state budget in the conditions in which are not appearing reflected at the debts, with reference at the treatment regulated by the fiscal policies. In order to avoid distortion of the results and financial equilibrium indicators taken in consideration, we consider necessary treating the retains from revenues, as warrantees for good execution, like not-taxation revenues from the fiscal point of view and the necessity of registering in the accounting of the transfer from the claims, account 411"clients" to the 2678 (other immobilized claims).

More relevant it seems the accounting and fiscal approach from the point of view of the solutions offered by IAS 12 TAX ON PROFIT(revised), in which the revenues related to the good execution warrantee should be taxed and treated like delayed tax on profit. In this situation the expenses with the tax on profit will be cumulated, the tax on the current profit and the tax on the delayed profit, like the registration 6191”expenses regarding delayed tax on profit” =4412 “delayed tax on profit”. The determination of the results, according to above presented data, comprised in the table no. 2, reflect significant differences over the situation presented in the table 1 with influences over the raw profitability rate indicators (table 3)

Table 2

| | 2004 | 2005 | 2006 |
|---------------------------------|----------------|----------------|----------------|
| EBE | 3156124 | 2401164 | 2653966 |
| Expenses amortization | 247668 | 305001 | 346220 |
| PROFIT FROM EXPLOITATION | 2908456 | 2096163 | 2307746 |
| Financial Revenues | 217654 | 372939 | 176317 |
| Financial Expense | 70648 | 108021 | 46913 |
| RAW PROFIT | 3055462 | 2361081 | 2437150 |
| Tax on profit | 742322 | 360155 | 358360 |
| Current | 657936 | 299331 | 319655 |
| Delayed | 84386 | 60824 | 38705 |
| NET PROFIT | 2313143 | 2000926 | 2078790 |

The Art.222, line.3, of the Accounting Regulations from Directive IV of EEC foresees that the distribution of the profit should be registered in the accounting on “destinations established by the general assembly of the shareholders, after the approval of the financial situation reports”.

Table 3

| | 2004 | 2005 | 2006 |
|-----------------------|----------------|----------------|----------------|
| Annual revenue | 20981025 | 21060050 | 13705570 |
| RAW PROFIT (a) | 2717918 | 1980929 | 2932906 |
| RAW PROFIT (b) | 3055462 | 2361081 | 2437150 |
| Raw profit rate (a) | 13,00 | 9,4 | 21,40 |
| Raw profit rate (b) | 14,56 | 11,21 | 17,78 |

In this report, in the balance sheet, the results, excepting the legal reserves will appear distributed in the account 117 “the reported result”, contributing to the determination of an increased circulation fund, raised with the profit allocated to the consummation under the form of dividends with distortion, as well, to the indicators of solvability and liquidity. In order to cancel

these inconvenient we consider necessary the completion of the Norms for applying of the Ordinance 34/2006, approved by the Decision of the Government 925/2006, through the necessity of elaboration of a balance sheet ulterior to approval of distribution of the profit by certified consulting companies, which should certify the correctness of the solvability indicators and the financial capacity of the bidder companies.

Following the changes brought to the Fiscal Code, the taxpayers will pass from a quarterly determination of the tax on profit to an annual determination of it.

- The tax will be paid quarterly and will be represented by anticipated payments, estimated in concordance with the tax paid in the previous year.
- The modifications are taking, at least theoretically, to a simplification of the procedure of determination and payment of tax on profit, having some advantages and disadvantages:
 - in the conditions in which the activity is on a rising trend, so the profit rises, the company pays under the form of anticipated payments a lower tax in the period of the year than in the actual system, benefiting, till the regularization, by a fiscal credit from the state.
 - exemption from the tax under the form of anticipated payments in the quarters in which the company registers losses.
 - the company registers a decrease of the profit comparing to the last year, without having losses, the anticipated payments within the years are taking to payment of a higher tax than that resulted on the basis of the real results, the company crediting in this way the state till the recovering of the tax paid in advance.

Taking in consideration the article 160 line (2) letter c) from the Fiscal Code, the works of construction enter in the category of goods and services for which, for their delivery and execution, are applied the simplification measures, with the compulsory condition that both the contractor and the beneficiary of the construction works should be registered as VAT payers.

According to the regulations it's resulting that the companies which are registered as VAT payers will recover the paid VAT (concerning the bought construction materials) just after the operations of reimbursement of the VAT made by the fiscal organizations. In this situation the construction company is put in the situation to lend the state for a certain period of time from the moment it pays the VAT, concerning the acquisition of construction materials, till the moment it obtains the reimbursement of VAT. We consider obsolete the legal regulations for reimbursement of the VAT and it's essential the adoption of a regulation for reimbursement, on own company's responsibility after most 30 days, with realization of future controls by the fiscal organisms, in contrary, being affected the liquidity and the actual financing capacity of the companies from the construction industry.

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