

## FINANCIAL MANAGEMENT OF THE INVESTMENT CYCLE

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### Abstract

Any modern entity operates with the purpose to generate profit, and also to generate sufficient cash flow as to cover its operations and to never be in the position of being unable to cope with payments. Depending on the financial policy, part of the earnings of the entity can be used to sustainable purchase fixed assets. It is known that an entity needs investments in order to develop. to make investments, it needs financial sources. Nowadays, the access to resources, and especially to external resources, is becoming increasingly difficult. Therefore, any responsible entity takes measures to increase its capacity to self-finance. The capacity to self-finance reflects the financial potential for economic growth of an entity, namely the internal source of financing, and one of the important elements that influence the capacity of self-financing is depreciation. For this reason, the way depreciation is approached within an entity is a decision matter os the management.

**Keywords:** investment, assets, profit, service life, value, cost, depreciation

**JEL Classification:** E62, H20

### 1. Introduction

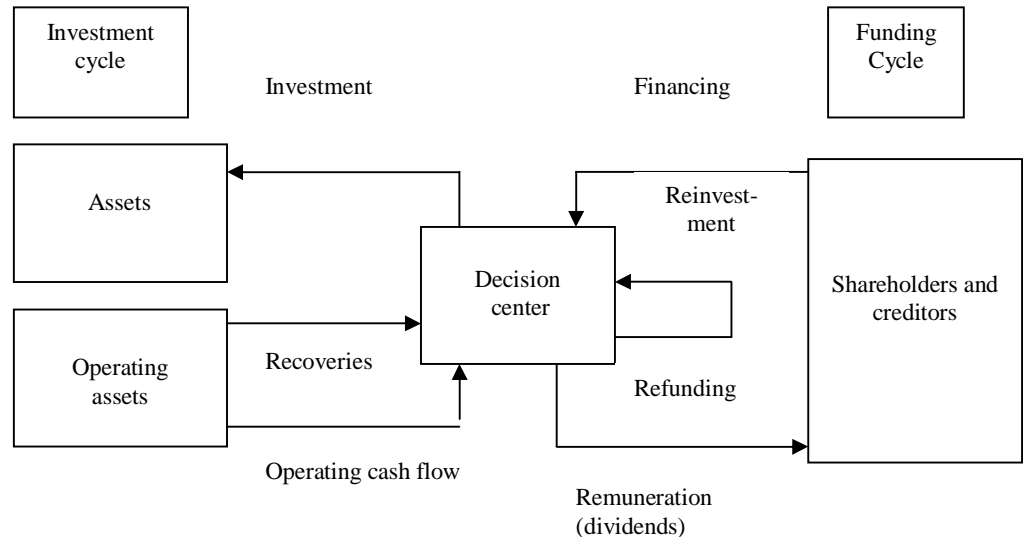
From an economic point of view, a cycle is defined as the sequence of events that occur through the evolution of an economic process.

An investment cycle corresponds to the acquisition of assets needed to maintain or increase productive capacity. It is divided into two phases: the purchase, representing the initial cost (cost) and recovery, reflected by the decrease in value due to physical and moral depreciation.

Consequently, Dumiter (2013, p. 9) argues: "the entity treasurer is the leader vis – á – vis of the tectonic movement of capital, as well as the appropriate protection measures, all these elements necessitating the enrolment of a whole set of proceedings like a puzzle that will be enriched in the managerial program of the company".

## 2. Material and methods

Investments are an expression of the selection decision among several versions of business development projects. Their funding needs to be provided from sources that can cover the expenses throughout the entire business cycle. As a result, the business needs to acquire resources that would meet the need of financing the investments in a consistent manner (Figure 1).



**Fig. 1 - The investments cycle and the funding cycle**

Source: Charpentier P. et. all, Organization and business management, Economic Publishing, Bucharest, 2002, pag.431.

### 2.1. Financial management of fixed assets

Modern businesses work towards making profit, and also to produce enough money to cover their operations and to avoid being unable to cover their expenses. Depending on their financial policies, part of the profit made can be used to purchase fixed assets.

Unlike other assets, intangible assets are acquired by the business in order to be kept and used for a longer period of time (over one year), aiming purposes other than immediate consumption or sale.

FASB (Statement of Financial Board) defines intangible assets as assets with the following characteristics:

- are intended to be used for more than one year;
- are purchased in order to be used in the course of operation;
- are not purchased for resale to customers.

IASC (International Accounting Standards Committee) defines intangible assets as those that:

- are intended to be used for the production of goods or services, to be rented to others, or for administrative purposes;
- are expected to be used over a period longer than one year.

Romanian law defines assets, referring to the tangible ones, as an object or complex of objects used as is and which meets the following requirements<sup>6</sup>:

- "have an input value greater than the limit established by the Government Decision;
- have a typical duration of use of more than one year. "

Another definition is found in the OMPF 3055/2009<sup>7</sup> which:

■ in Section 4, provisions on balance sheet items, item 28 shows that "Presentation of assets as fixed assets or current assets depends on the purpose for which they are intended, according to the accounting policies approved by the directors or the people who are responsible with the management of the business."

■ also, in Section 8 -assessment rules, paragraph 64 and 65, shows that the "fixed assets are assets generating future economic benefits and are acquired for a period that exceeds one year.

Tax legislation in Romania<sup>8</sup>, defines the fixed asset as "any tangible asset which is acquired to be used in the production or supply of goods and services, to be rented to others or for administrative purposes, if it has a utilization span greater than one year and a value greater than the limit established by governmental decision."

Hence, a part of the Romanian law imposes minimum value requirements in addition to time requirements, value that can be updated periodically based on the inflation rate or the amount of eventual upgrades. A different part of the law (accounting law) recognizes assets only depending on their lifespan, of the ability to bring future economic benefits and reliable assessment. From the above results that professionals have an obligation to differentiate among the accounting treatment and the taxation treatment.

Even if the goods meet the lifespan criteria and value criteria provided for assets to be recognized and presented as such, they shall, in addition, meet as well the following:

- future economic benefits criterion- assets are recognized in the financial statements only if they generate future economic benefits to the entity;
- credible evaluation criterion - the cost of the asset can be determined as to be truthful;
- possibility of control criterion - the asset to be a resource controlled by the entity, both physically and in terms of future economic benefits;

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<sup>6</sup> Law on depreciation of fixed tangible and intangible, republished, with subsequent amendments, 15/1994 updated, Official Gazette 242/31.05.1999

<sup>7</sup> OMF.3055/2009 for approval of accounting regulations compliant with European Directives, as amended cf. Order MFP No. 2067/2013 for approving the Accounting Regulations in accordance with European directives (Official Gazette Official Gazette 766 + 766 bis) (Republished UTG)]

<sup>8</sup> Law 571/2003 regarding the Fiscal Code, point 17.

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■ possibility of control criterion - the asset to be a resource controlled by the entity, both physically and in terms of future economic benefits;

■ possibility of identifying criteria - applicable to intangible assets, requires distinct identification from goodwill;

Specific to assets in general and to tangible particularly, is the wide gap between the acquisition date, which implies an outflow of financial resources, and the moment of full recovery of the value through costs, in particular the sales price, as an input of resources. The recovery periods for intangible assets through cost or selling price are determined by the lifetime of the assets.

In Romania, assets lifespan is determined by national<sup>9</sup> rules lately, the utility criterion provided by IAS 16, Property, Plant, is adopted by the laws of Romania.

Entity's management may establish a lifetime lower than those stipulated by the law, called the useful life, seeking faster recovery of the fixed assets value through cost or price.

Useful lives are designed to counteract the effects of moral wear as a result of technical progress, or market effects, which demand a different type of products or services, which, in most cases, involve changes in technology.. If the entity does

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<sup>9</sup> H. G. 964/23.12.1998 for the approval of classification and useful life of fixed assets

not consider these issues, it will likely be surpassed by competition, which uses performing plants with low consumption and high labor productivity, resulting in low costs of goods or services. Also, in many cases, the entity does not have sufficient funding sources as to enable a rapid change of technology, as the value of assets that needs replacement has not been recovered through depreciation, having to settle for lower recovery times. The effects of such a decision are presented in Table 8, which shows the effect of the "automatic molding and casting line" asset lifetime upon its depreciation and upon the remaining value.

**Table 1 - Effect of useful life upon depreciation**

Name of asset	Acquisition value	Classification code	Lifetime - year -		Depreciation calculated linear - mii lei-				Value remaining in year 7	
			See HG normal. 964/98	Useful	Annual by:		Cumulated at the end of 7 by:		After the normal life	After the useful life
					Normal life	Useful life	Normal life	Useful life		
0	1	2	3	4	5(1/3)	6(1/4)	7(4*5)	8(4*6)	9(1-7)	10(1-8)
Automatic casting line training	21.530	2.5.1.1	15	7	1.435	3.076	10.047	21.530	11.483	0

Source: author's view

As shown in spread 1, in the 7th year, the situation is as follows:

- as of normal service life, the entity recovers 53% of the purchase price, 10.047 mil. respectively, contributing in a lower level to the increase of funding sources - with a lower pressure on costs;
- as of useful service life, the company fully recovered the purchase value, respectively 21.530 million Lei, which will help increase funding sources, allowing the entity to replace the automatic molding-casting line after only 7 years, but with higher pressure on costs.

## 2.2. Depreciation of fixed assets, source of investment financing

Information on depreciation is information with implications for the financial management of the entity; it is information about the self-financing capacity, as well as about the computation of indicators related to the sustainable assets of the entity.

Both national law and financial reporting standards<sup>10</sup>, require that asset depreciation by the systematic allocation of the depreciable amount during their lifetime. The difference between the National Law and the International Accounting Standards is in the determination of the lifetime of fixed assets. While national legislation<sup>11</sup> establishes that the depreciation of assets is based on the

<sup>10</sup> IAS 16, property, plant

<sup>11</sup> Law on depreciation of fixed tangible and intangible, republished, with subsequent amendments, Official Gazette 242/31.05.1999

depreciable amount and duration of normal service, IAS 16 states that depreciation is calculated based on the estimated useful life. Useful life is the period over which an asset is expected to be used by the entity.

International Accounting Standards permit useful life to be determined by professional judgment, considering:

- projected rate of wear and tear for the asset;
- economic circumstances in asset operation;
- any limitations that the entity might encounter in the use of the asset;

According to the standard, the useful life may be revised periodically, adjusting the related depreciation expense in future periods, unless there are serious indications that new factors have emerged, and which require, for example, to carry out upgrading works, which would lead to extending the useful life.

**Table 2 - Effects of normal service periods upon financial statements**

Category	The fixed assets	Normal service times. According 15/1994 and HG. 2139/2004	Effects on financial statements	
			Balance sheet	Profit and loss account
Tangible assets	Land	unlimited, except for lands with economic destination	does not change	does not influence
	Construction	between 4 years and 60 years	decreasing the value as a result of wear	influence amortization costs related to wear
	Equipment (machinery, equipment, installation work)	between 3 years and 24 years	decreasing the value as a result of wear	influence amortization costs related to wear
	Machinery and equipment for measuring, control and regulation	between 2 years and 36 years	decreasing the value as a result of wear	influence amortization costs related to wear
	Means of transport	between 3 years and 24 years	decreasing the value as a result of wear	influence amortization costs related to wear
	Animals and plantations	between 2 years and 70 years	decreasing the value as a result of wear	influence amortization costs related to wear
	Furniture, office equipment, protective systems of human values and materials and other corporal assets	between 2 years and 24 years	decreasing the value as a result of wear	influence amortization costs related to wear
Intangible assets	Formation expenses	up to 5 years	decrease the amount included in cost	influence amortization costs associated
	Patents, licenses, know-how, trademarks, trade and services and other industrial and commercial property rights similar	period used	decrease the amount included in cost	influence amortization costs associated
	The goodwill	up to 20 years	decrease the amount included in cost	influence amortization costs associated
	Computer programs	up to 5 years	decrease the amount included in cost	influence amortization costs associated
	Intangible assets	up to 5 years, except the goodwill whose duration is up to 20 years	decrease the amount included in cost	influence amortization costs associated

Source: author's view

## Conclusions

As shown, the normal lifespan is determined by state institutions, considering more physical criteria rather than economic criteria, pursuing particularly the fiscal side rather than the economic side. To note is that the national law does not prohibit the establishment of other lifetimes, to be used in the calculation of the depreciation, excess depreciation is not considered for tax purposes.

According to Romanian Law, normal service times vary according to the category the assets belong to, ranging between 3 and 60 years, fiscally agreed upon, influencing differently the financial statements of enterprises.

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