

Credit Institutions – Financing Entities During the COVID-19 Pandemic

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Abstract

The impact of the COVID-19 pandemic affected the financial situation of debtors, both individuals and legal entities, as they sought to find the best solutions for the recovery and functioning of their business. This paper aims to analyse the decision to finance an economic entity during the COVID-19 pandemic, generated by the need to acquire a tangible fixed asset necessary to carry out the core business. For this purpose, a series of financial and accounting aspects regarding the financing alternatives are highlighted using the following research tools: the observation method, the descriptive method, the case study method.

Keywords: financing decision, financial leasing, bank loan, pandemic, debtor.

1. Introduction

The application of restrictive measures to combat and prevent the spread of the SARS-CoV-2 virus, initially established by the Decree of the President of Romania no. 195/2020 regarding the establishment of the state of emergency on the territory of Romania and later extended by the Decree of the President of Romania no. 240/2020, had adverse repercussions on the financial situation of debtors, individuals and/or legal entities, in certain cases their incomes were significantly reduced.

For companies, an alternative in terms of financing is the leasing system. This option is a solution when the company does not have sufficient liquidity to purchase the goods, using them in exchange for a periodic payment, thus managing to finance the investment within the company.

Another way of financing an investment in the case of an entity is through bank loans. The important factors in the lending decision are the financing costs that the company will have to bear, taking into account the financial potential and the economic management plan.

Although numerous comparative studies have been carried out over time regarding financing alternatives through leasing and credit purchase, it is very difficult to assess which of the two methods is more advantageous.

2. Reanalysis of specialized literature

The normative act that regulates leasing operations in Romania is the Government Ordinance no. 51/1997 on leasing operations and leasing companies, republished, with subsequent amendments and additions. According to art. 1 paragraph (1) of this normative act, leasing operations are defined as those through which one party, called the lessor/financier, transfers for a determined period the right of use over an asset, the owner of which is, to the other party, called the lessee/user, at its request, against a periodic payment, called the leasing rate, and at the end of the leasing period, the lessor/financier undertakes to respect the option right of the lessee/user to buy the asset, to extend the leasing contract without changing the nature leasing or to terminate contractual relations. The lessee/user can choose to buy the tangible fixed asset before the end of the leasing period, but not

earlier than 12 months, if the parties so agree and if they pay all the obligations assumed by the contract.

At art. 2 lit. d) the ordinance defines the leasing rate, distinguishing between financial leasing, in which the rate represents a share of the input value of the asset and the leasing interest, which is established based on the interest rate agreed by the parties, and operational leasing, in which the rate represents the rent, which is determined by the agreement of the parties.

Also, references to the development of leasing contracts in Romania can be found in Law no. 227/2015 regarding the Fiscal Code, with subsequent amendments and additions, to title I "General Provisions", art. 7 points 7-8, as follows:

➤ **financial leasing contract** - any leasing contract that meets at least one of the following conditions:

- a) the risks and benefits of the right of ownership of the asset that is the object of the lease are transferred to the user at the time when the leasing contract takes effect;
- b) the leasing contract expressly provides for the transfer of ownership of the asset that is the object of the lease to the user at the time of the expiration of the contract;
- c) the user has the option to buy the asset at the time of the expiration of the contract, and the residual value expressed as a percentage is less than or equal to the difference between the maximum normal operating time and the duration of the leasing contract, compared to the maximum normal operating time, expressed as a percentage ;
- d) the leasing period exceeds 80% of the maximum normal operating time of the asset the object of the lease; within the meaning of this definition, the leasing period includes any period for which the leasing contract can be extended;
- e) the total value of the leasing installments, minus the accessory expenses, is greater than or equal to the input value of the asset";

➤ **operating leasing contract – any leasing contract concluded between the lessor and the lessee, which transfers**

to the lessee the risks and benefits of the right of ownership, less the risk of capitalizing the asset at the residual value, and which does not meet any of the conditions provided for in point 7 letter. b)-e); the risk of capitalizing the asset at its residual value exists when the purchase option is not exercised at the beginning of the contract or when the leasing contract expressly provides for the return of the asset at the time of contract expiration".

Taking into account the criteria according to which it is classified, leasing takes several forms.

According to Vintilă (2004), it can be movable and immovable, related to the involvement of the parties, directly or indirectly, and depending on the procedures for calculating the rates, it can be net or gross. In Romania, a special form of leasing is sale-and-leaseback, characterized according to the authors Molico and Wunder (2003) by the fact that the leasing user, first of all the owner of a leased object, sells and assigns ownership of this object to a lessor of leasing, in order at the same time to get it back for use on the basis of a leasing contract.

From an accounting point of view, companies that are required by law to use International Financial Reporting Standards as the basis of their accounting will apply IFRS 16 Leases. In Romania, the general legal accounting regulation for the application of IFRS is the Order of the Minister of Public Finance no. 2.844/2016 for the approval of the Accounting Regulations in accordance with the International Financial Reporting Standards, with subsequent amendments and additions. Mihalciuc (2019) states that the provisions of IFRS 16 apply to all companies that report financially according

to International Financial Reporting Standards (listed or unlisted companies that have chosen IFRS for consolidated accounting, including their subsidiaries) and, also, the majority of leasing contracts, including those for assets related to the right of use within a leasing subcontract, with certain exceptions provided by the standard (leasing regarding the exploration of ores or biological assets, service concession commitments, intellectual property rights, license). In our country, the entities obliged to report according to IFRS are credit institutions, non-banking financial institutions, insurance and reinsurance companies, brokerage companies, as well as companies listed on the Bucharest Stock Exchange.

Companies that do not fall into this category apply the provisions as the basis of accounting Order of the Minister of Public Finance no. 1,802/2014 for the approval of the Accounting Regulations regarding individual annual financial statements and consolidated annual financial statements, with subsequent amendments and additions.

With regard to lending activity in Romania, credit institutions grant loans only in compliance with the legal regulations in force, namely Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy, with the subsequent amendments and additions, of internal normative acts and internal approval powers. Loans are granted in the local currency and in all currencies quoted by the National Bank of Romania, under the cost conditions established by the Bank's Steering Committee (David, 2009).

In order to come to the aid of debtors in difficult situations from a financial point of view, caused by the outbreak of the COVID-19 pandemic, in Romania the Government's Emergency Ordinance no. 37/2020 regarding the granting of facilities for loans granted by credit institutions and non-bank financial institutions to certain categories of debtors, which provides for a series of measures aimed at facilities for holders of leasing contracts and credit contracts, which has subsequently undergone changes.

In the category of creditors who can grant the facilities, according to art. 1 lit. a) from the normative act mentioned above, credit institutions defined according to GEO no. 99/2006 and non-bank financial institutions defined by Law no. 93/2009, with subsequent amendments and additions, as well as the branches of credit institutions and non-bank financial institutions from abroad that carry out activity on the territory of Romania. Financial leasing companies are established in the form of joint-stock companies and as non-banking financial institutions, while operational leasing companies are established and operate according to Companies Law no. 31/1990, republished, with subsequent changes and additions, OG no. 51/1997 requiring them to have as their main object of activity the carrying out of leasing operations and a minimum share capital, subscribed and fully paid in cash, upon establishment, equal to the equivalent in lei of the sum of 200,000 euros. The period for which the suspension of payment obligations can be requested is between one and nine months, without being able to exceed the date of December 31, 2020.

3. Research methodology

In order to achieve the objective formulated regarding the subject addressed, the study is based on certain methods of scientific research: the observation method, the descriptive method and the case study method.

4. Research results

The objective of the research is the analysis of the financing decision in the case of an economic entity, during the COVID-19 pandemic, generated by the need to purchase a tangible fixed asset necessary for the performance of the basic activity. For this, we chose a micro-enterprise economic entity whose main activity is transport, whose turnover is less than 100,000 euros. In order to carry out the basic activity, the company administrator analyzes the need to purchase a truck intended for the transport of goods and decides that it is indispensable in carrying out his activity, considering that it is not appropriate to choose a rental service in this case. From the offer of existing financial institutions

on the market, the company's representative opts for Banca Transilvania, going to decide which is the financing option that benefits him the most: financial leasing or bank credit.

5. Presentation of the financial-accounting aspects based on a financial leasing contract

Contract conditions

If the transport company concludes a financial leasing contract for a period of 4 years with BT Leasing Transilvania IFN SA in May 2020, for a truck intended for the transport of goods, the contractual clauses provide for a contract value of 120,000 lei, while the advance that must be paid by the lessee is 25% of the value of the immovable asset. Also, the costs regarding this type of financing can be found in the interest charged by the lessor, of 7.9%, and in the monthly management fee, of 20 lei, while the file analysis fee is 450 lei. The company will also pay a monthly insurance in the amount of 254.72 lei to BT Intermedieri Agent de Asigurare SRL.

From the analysis of the repayment schedule of the financial leasing installments, the specifics and value of the expenses borne by the company can be seen as follows:

- total interest payment (financial expenses) – 7,110 lei, representing a monthly value of 148.12 lei throughout the financing period;
- insurances and commissions (operating expenses) – 13,187 lei, of which 960 lei – the management commission with a monthly value of 20 lei during the financing period and 12,227 lei – the insurance borne each month during the contractual period, in the amount of 254.72 lions;
- the amount to be paid – 140,297 lei, respectively 120,000 lei – the value of the contract and 20,297 lei – the expenses related to the contractual period;
- total to be paid, with the file analysis commission, in the amount of 450 lei - 140,747 lei.

The flow of accounting records in the case of financial leasing

Based on the contract concluded with the leasing company, the lessee makes the following entries in the accounting:

In May 2020:

- Receipt of the advance invoice (25%):

| | | | | |
|-------------------|----------------------|---|----------------------|------------------|
| | | = | | |
| <u>35.700 lei</u> | % | | <u>404</u> | |
| <u>30.000 lei</u> | 4093 | | „Property providers” | <u>35.700lei</u> |
| | | | ” | |
| | Advances granted for | | | |
| | tangible assets” | | | |
| <u>5.700 lei</u> | <u>4426</u> | | | |
| | „Deductible VAT” | | | |

- Payment by bank transfer of the advance invoice:

| | | | | |
|------------|----------------------|---|------------------------|------------|
| 35.700 lei | 404 | = | 5121 | 35.700 lei |
| | „Property providers” | | „Bank accounts in lei” | |

- Registration of the financial leasing contract:

| | | | | |
|-------------|----------------------|---|-------------------------------------|-------------|
| 120.000 lei | 2133 | = | 167 | 120.000 lei |
| | „Means of transport” | | „Other assimilated loans and debts” | |

- Highlighting the interest in off-balance sheet accounts, according to the due date ((120,000 lei–30,000 lei) x 7.9%):

| | |
|--------------------|-----------|
| Debit 8051 | 7.110 lei |
| „Payable interest” | |

- Retention of the advance:

| | | | | |
|------------|-------------------------------------|---|--|------------|
| 30.000 lei | 167 | = | 4093 | 30.000 lei |
| | „Other assimilated loans and debts” | | „Advances granted for tangible assets” | |

The tax on the means of transport owed to the local public administration by the lessee, according to Art. 471 para. (6) lit. a) and b) of the Fiscal Code, will be determined by the taxation decision issued starting from the first day of the year following the one in which the financial leasing contract was drawn up.

The lessee's obligation when he takes over the asset in the financial leasing system is to submit the tax declaration to the tax authority in whose territorial competence the means of transport will be registered, within 30 days from the preparation of the process- handover-receipt report.

- Registration of the invoice regarding the file analysis commission:

| | | | | |
|-------------------|--|---|-------------|------------------|
| 535,50 lei | % | = | <u>401</u> | <u>535,50lei</u> |
| <u>450,00 lei</u> | 628 | | „Providers” | |
| | „ Other service charges executed by third parties” | | | |

| | |
|------------------|------------------|
| <u>85.50 lei</u> | <u>4426</u> |
| | „Deductible VAT” |

- Payment by bank transfer of the file analysis commission:

| | | | | |
|------------|-------------|---|------------------------|------------|
| 535,50 lei | 401 | = | 5121 | 535,50 lei |
| | „Providers” | | „Bank accounts in lei” | |

In June 2020:

- Receipt of the financial leasing invoice related to the first installment:

| | | | | |
|--------------|---|---|----------------------|--------------|
| 2.431,32 lei | % | = | <u>404</u> | 2.431,32 lei |
| 1.875,00 lei | 167 | | „Property providers” | |
| | „Other service charges executed by third parties” | | | |

| | | | |
|------------|--|--|--|
| 20,00 lei | 628 | | |
| | „Other service charges executed by third parties” | | |
| 148,12 lei | 666 | | |
| | „Costs regarding interest” | | |
| 388,20 lei | 4426 | | |
| | „Deductible VAT” | | |

- Payment by bank transfer of the invoice:

| | | | | |
|--------------|----------------------|---|------------------------|--------------|
| 2.431,32 lei | 404 | = | 5121 | 2.431,32 lei |
| | „Property providers” | | „Bank accounts in lei” | |

- Non-accounting registration of the interest paid:

| | |
|--------------------|------------|
| Credit 8051 | 148,12 lei |
| „Payable interest” | |

- Depreciation recording:

Being a financial leasing contract, it entitles the lessee to record the depreciation of the asset in accordance with the accounting policies practiced by him. Thus, the amortization method chosen is the linear one, the value related to the operating expenses regarding the amortization being calculated as follows:

Annual depreciation = Entry value/Lifetime = 120,000 lei/4 years = 30,000 lei

Monthly depreciation = Annual depreciation/12 months/year = 30,000 lei/12 months = 2,500 lei

| | | | | |
|-----------|---|---|--------------------------------|-----------|
| 2.500 lei | 6811 | = | 2813 | 2.500 lei |
| | „Operating expenses regarding depreciation and means of transport” | | „Depreciation of fixed assets” | |

- Receiving the invoice for insurance services issued by the insurance company:

| | | | | |
|------------|----------------------|---|-------------|------------|
| 254,72 lei | 613 | = | 401 | 254,72 lei |
| | „Insurance expenses” | | „Providers” | |

- Payment by bank transfer of the invoice for insurance services:

| | | | | |
|------------|-------------|---|------------------------|------------|
| 254,72 lei | 401 | = | 5121 | 254,72 lei |
| | „Providers” | | „Bank accounts in lei” | |

The company will record these operations until the date of completion of the financial leasing contract.

Costs of financing through the financial leasing contract

The expenses that the company must bear monthly can be found in the commission charged by the lessor, the interest related to the financial leasing contract and the amount of insurance expenses. These are maintained at a constant value, at a total of 422.84 lei, of which 148.12 lei - interest, 20 lei - management commission and 254.72 lei - insurance. The monthly installments also bear the VAT rate, being deducted from the invoices received from the insurance company and the lessor. The total financing costs amount to 20,747 lei, of which 7,110 lei - total interest, 960 lei - total management fees, 12,227 lei - total insurance paid, the latter registering the highest value of the total costs, and 450 lei - the commission file analysis, initially supported.

6. Conclusions

The COVID-19 pandemic has affected the activity of all economic entities, which are obliged to adapt their financial and accounting policies to the new requirements. The Romanian authorities came to the aid of debtors in difficulty by issuing GEO no. 37/2020, which, under certain conditions, helps them benefit from the suspension of payment obligations. The financing decision during the pandemic was affected by a slight increase in interest costs and commissions related to existing financing instruments in Romania. In the case of our study, the financial leasing situation and the bank loan offered by Banca Transilvania were compared. The advantages of credit-based financing are: the asset passes into the beneficiary's patrimony as soon as the contract is signed, there is the possibility of refinancing the loan at another bank, and the beneficiary can determine the period for which he wishes to contract the loan. The disadvantages of credit-based financing are: a longer period of approval of the credit file, the need for additional guarantees and higher financing costs.

The advantages of financing based on the financial leasing contract are: the signing of the leasing contract takes place in a short period, the conclusion of such a contract does not require the existence of additional guarantees, access can be made by a wider range of users, the right of use is acquired even if the full payment of the asset has not been made, and the interest expenses are tax deductible. The disadvantages of financing on the basis of the financial leasing contract are: the mandatory payment of an advance as a percentage of the contract value according to the contractual commitment, possession of the asset is possible only at the end of the contract, after the full payment of the installments, through the option shown by the lessee, maintenance expenses and the repairs of the property are borne by the lessee.

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