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# DETERMINING THE COST - A DECISIVE FACTOR IN CAPITAL BUDGETING IN THE PUBLIC SECTOR-STATE

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## Abstract

Management of enterprises always must be ready and willing to do the analysis that can only select the best solutions in the implementation of tasks and achieving goals whether it is for organizations and units of private and state public sector.

Specifically, the creation (collection) of funds and their spending is normally really difficult task, that should be implemented. The preliminary decision is the way in which the funds will be provided, and the second one is how they will be useed (spent). In the totality of spending, the most dificult is when you get to the necessary idea to purchase capital assets that require large funds ie large costs. Therefore, in this paper addition to working to improve the way you do a review of meaning making, choice of two or more alternatives, and determining the cost perceived by the financial statements of a given organization.

*Keyword: management, determining costs, financial statements, budgeting capital, decision making.*

## 1. INTRODUCTION

In the evolutionary process of many phenomena are constituting a wider range of thoughts and creating and innovating of new things. If we take for example the system of registration and recording of the early traders, which later grew into running a bookkeeping and accounting and later formation of modern accounting systems. In daily operations and functioning of the private and profit enterprises, and with the state and public companies and nonprofit organizations as well AIS is confirmed as a factor of paramount importance in decision-making and budgeting of funds in the organization.

Especially today, in the market and open society with democratic principles of action in any national economy there is no event or any other transaction that is not recorded in the accounting information system. In all spheres of activity ranging from economic, political, social or any other aspect managers must bring proper, development and specific decisions. This is the power of a state, of a national economy.

Therefore, we can say rightly that the state non-profit sector, today is in a great development and occupies 1/3 of the total cost of the economy of the United States and other Western developed economies.

This sector aims to meet the needs of citizens and the basic cell growth and development of society. And here are the highlights, "there are not developed state without citizens' satisfaction."

Which means, that the state may appear as a generator of certain products and power that will be activated at multiple levels to meet the needs of society ie citizens.

## 2. THE ROLE OF FINANCIAL REPORTING IN THE PUBLIC SECTOR-STATE

In the dynamic process of action and functioning of institutions and business entities whether they are private or public sector there is a need for understanding and determining costs.

Also, budgeting of capital spending is plan that managers decide whether certain funds to buy or sell. In fact, the budget is the subject of analyzing alternatives which decisions should be made. The financial statements as an instrument for measuring the size as the total capital, and the costs can allow the most complex point to be able to predict the cost and possibility of return of capital into the institution. These decisions require careful analysis in terms of weight and the risk to faced by managers.

Namely, the question is: "What is the risk if the institutions would have the funds?" Especially if you invest own capital, not borrowed (credit, loans etc.). First, the weight is present as required in predicting long-term event and, second, the risk is present because the outcome is uncertain, the investment is a major asset, but the future is uncertain.

Specifically, capital budgeting in the correct direction, perceive through proper and accurate determination of costs, which in the future will result in a very low level of risk, and you will realize the anticipated positive trend in return on equity (ROE).

## 3. APPLICATION EXAMPLE FOR THE ALTERNATIVE CHOICE AND INVESTMENT IN CAPITAL ASSETS

In addition of the paper through an example will see the significance and importance of the calculation of the indicators and the calculation of costs. We assume that a state company has acquired the machine to produce the new product.

Example:

That machine cost 11,000 euros.

It is expected to use 10 years and to produce 4,000 units of the new product.

The managers of this firm are tasked to calculate:

- the annual net cash flow,
- to define and determine the costs, and calculate what would be the period of return on investment.

| Num. | Inventory | Units | Price (euro) | Expected amounts |
|---|---|---|---|---|
| 1 | Annual production of the new product | 400 | 19 | 7.600 |
| 2 | Annual costs | | | 4.200 |

| | | | | |
|---|---|---|---|---|
| | - Cost of materials, 1.200<br>- Labor cost,<br>- Administrative cost,<br>- Overheads. | | 1.200<br>2.400<br>400<br>200 | |
| 3 | Depreciation | | | 700 |
| 4 | Annual income before tax | | | 2.700 |
| 5 | Income tax 30% | | | 810 |
| 6 | Annual net income | | | 1.890 |
| 7 | Annual cash flow | | | 2.590 |

Figure 1. Analysis and calculation of the decision to invest in fixed assets (machinery).

Calculation:

1 machine: 11.000 €

Period of use: 10 years

Production : 4.000 units for 10 years.

4.000 : 10 = 400 units for 1 year.

1 – (2+3) = 7.600 – 4.900 = 2.700 (annual income before tax).

1 – (2+5) = 2.590 (annual cash flow).

$$\text{Return of equity} = \frac{\text{Cost of investment}}{\text{Annual cash flow}} = \frac{11.000}{2.590} = 4{,}24$$

ROE = 4,24

From the previous we can see, what is the period of return of equity, which is invested at the beginning.

Namely, in our case the initial investment fully returned for 4.24 years.

Here we will make reference to the issue: What will happen if the management team made a choice for another machine?

This confirms the importance of the financial statements at the beginning of the idea can very clearly and accurately gauge performance and to obtain information that reflect the budget of the institution, and also can compose budgeting of government entity in the future.

As can be seen from the table, managers through financial statements made:
- Analysis of alternatives,
- Evaluation of the value of the item and its usefulness,
- Prediction of cash flow,
- Prediction of the return period,
- Comparing the results of several alternatives,
- Prediction of inflation,
- Other things.

In making its final decision, the managers based on accounting data and information contained in the financial statements of public sector entities also need to make a judgment and qualitative characteristics of the equipment (machine).

## CONCLUSION

From the paper shown may be noted that no matter what decision it comes to what company, organization, entity in terms of private (manufacturing, service, sales, etc.), or a state institution, organization of non-profit nature, enterprise of the public sector and other state companies, it can be concluded that:

- Capital budgeting is the most uncertain, long-term (with a large sum of money) investment,
- You have to make the right decisions by managers, whether the entity private, state and public sector,
- In decision-making should not be calling from an intuitive feeling,
- Decision-making is conditioned by several factors, especially when there are multiple alternatives,
- The use of data and information from the accounts can be made more systematic analysis,
- The assessment and determination of costs reduces the risk of the invested money,
- Should make identification of the financial consequences of alternative choices,
- The importance of the qualitative features of the asset is just as important as the quantitative and price contingent upon the purchase or sale,
- The responsible managers need to know when to invest (buy or sell),
- Making a decision should be supported by using multiple methods,
- Managers should evaluate the decisions on capital budgeting.

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