ACCOUNTING POLICIES AND OPTIONS REGARDING TANGIBLE ASSETS' EVALUATIONS

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Abstract: Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity when producing and presenting financial statements. The options found in accounting mean there are several policies to settle a matter. Therefore, an option means a choice. The targets of choosing accounting policies are generated by the need to render a true and fair view regarding the financial statement and performance of an enterprise. Choosing the treatments to be applied by a company from among those allowed becomes in the context of flexibility permitted by accounting normalizers a very important factor when presenting a company's financial position and performance.

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1. INTRODUCTION

An accounting policy is laid down and borne by a company's management. It is accounting principles that lie at the core of laying down and bearing all accounting policies. In an economy that is not connected to political fiscality, an adopted accounting policy may ensure real, true information more easily which by its certification should be credible to all its users and meet the requirements related to truth according to fundamental accounting goals.

In regulated accounting, specific policies and procedures rely both on accounting principles and on the system of normative regulations. The reference system used to lay down accounting policies allows alternatives in terms of accounting entries and evaluations, namely various methods to evaluate and calculate a patrimony, earnings or a financial statement.

2. DEFINITION OF ACCOUNTING POLICIES AND ACCOUNTING OPTIONS CONCEPTS

Christopher Nobes (1999) defined accounting policies as the "detailed methods for evaluation, measurement and recognition (finding) an enterprise has chosen from among those generally accepted by the law, accounting standards or commercial practices. The policies must be continuously used and issued. An enterprise's annual report should include an annex on the accounting policies that have been applied in its financial statements."

IAS 8 accounting standard referring to "Accounting policies, changes in accounting estimations and errors" defines accounting policies as the typical principles,

bases, conventions, rules and practices applied by an entity while making up and submitting its financial statements.

In compliance with Directive 4, “accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity while making up and submitting its annual financial statements.”

As to J.F. Casta’s definition (1996), an accounting policy is “all the management choices regarding accounting variables which, if legislative constraints are obeyed, lead to arranging the content and form of financial statements. An accounting policy falls within a double approach to optimize the choices and financial relationships of an enterprise with its environment. A choice is made within a framework set up by the numerous sources of accounting laws and fiscal rules which especially apply to financial statements”.

Accounting policies are options for settling certain matters for the purpose of finding the optimum variant. The variables which can generate accounting policies when choosing and applying methods are:

- evaluation of assets;
- evaluation of inventories;
- accounting depreciation versus fiscal depreciation;
- set-up and resumption of provisions;
- accounting of long-term contracts;
- methods of account consolidation etc.

The best variant must meet the fundamental goal of accounting which is to provide real, correct, credible information to all users, including to fiscality.

From another perspective, accounting policies mean the options generated by certain concerns while in compliance with certain principles, rules, and conventions regarding the entry, recognition and evaluation of elements described by an accounting model, laying down and reporting financial statements (Ristea, 2000, p. 19).

Accounting policies must meet the principle of methods’ consistency, namely they must be used in several consecutive financial years. Thus, data can be compared from one financial year to another. If accounting policies change, this must be mentioned in the explanatory notes of financial statements.

The changes in accounting policies are allowed only if (Ristea, 2002, p. 44):

- they are required by the law;
- they are required by an accounting standard;
- they result in more relevant or more credible information on enterprise financial position and performance.

The changes in accounting policies have been quite recently included into the category of general accounting principles as they influence the quality and truthfulness of information provided by accounting. Firstly, this principle is important as it has to be consistently applied and therefore it contributes in ensuring the necessary conditions for the time comparison of information to be reported in annual financial statements and implicitly for analyzing the evolution of entities’ activities and management performance (Staicu, 2010, p. 16).

The presence of accounting options supposes the existence of several policies (namely bases, conventions, methods, rules or practices) and/or estimation techniques to solve a problem. An option is therefore a choice.

The goals of choosing an accounting policy are produced by the need to render a true and fair view of an enterprise's financial position and performance (Popa, 2011, p. 72).

What has been stated above leads to the fact that the essential element when evaluating accounting choices is the usefulness to make decisions. In order to make the difference between high-quality (more useful) information and low-quality (less useful) information, one should consider the features that make information useful. The features of accounting information and their ranking are mainly analyzed by means of a conceptual accounting framework. The information provided by financial statements must be:

- relevant – the information is relevant if it impacts users' economic decisions thus helping them assess past, present and future events;
- credible – the information must truthfully render an enterprise's earnings and financial position, reflect the economic substance of events and transactions not just a juridical form, be neutral that is unbiased, be prudent and complete in all its significant aspects.

3. ACCOUNTING POLICIES AND OPTIONS FOR THE EVALUATION OF TANGIBLE ASSETS

The original evaluation of a tangible asset is done at its cost which can be represented either by the cost of acquisition or the factory cost.

An asset's cost of acquisition is made up of its purchase price plus customs duties, non-recoverable fees and all directly attributable expenses committed to bring the asset to the state of its intended use. The purchase price is reduced by trade discounts and rebates.

The factory cost includes the purchase cost of raw materials and consumables, the factory expenses that are directly attributable to a product (energy consumption for technological purposes, direct man power and other direct factory expenses) as well as the share of factory financial overhead reasonably allocated as being related to manufacturing.

Factory costs should not include the loss of materials, man power or other factory expenses exceeding the normal limits, the storage costs except when they are needed during the manufacturing process previous to a new manufacturing stage, general management expenses (except when they are directly related to the asset's acquisition or putting into use).

Tangible asset evaluation at the balance sheet date is done for the entry value minus the accumulated value impairment. Additionally, national regulations state that entities can proceed to the revaluation of tangible assets existing in the end of a financial year, its results being reflected in accounting.

The revaluation method requires that subsequent to an asset's original recognition, a tangible asset should be reported at its revaluated amount. This is the fair value at the time of revaluation minus the accumulated depreciation and accumulated impairment loss.

Fair value is generated according to the evaluations of authorized auditors and a consequence of applying such a treatment is the need for simultaneous revaluation of the entire class the respective asset belongs to. The elements in an asset class are simultaneously revaluated in order to avoid selective revaluation and the reporting in financial statements of some values that are mixtures of costs and values calculated at different dates.

Professional judgment should be essentially exercised in the matter of revaluation, that is accounting professionals must set the revaluation rate according to the fair value significant progress and they must also state the treatment of accumulated depreciation at the revaluation date because revaluations should take place regularly enough so that the books value should not be too different from the one generated if the fair value were used at the balance sheet date.

On asset revaluation, any depreciation accumulated at the revaluation date is treated in one of the following ways:

- it is recalculated proportionately with the asset change in gross books value so that its books value after revaluation be equal to its revaluated amount;
- it is removed from asset's gross books value and its net amount is recalculated at the asset's revaluated amount.

If assets revaluation takes place, the difference between the amount after revaluation and the historical cost value must be entered as revaluation reserve.

Example: Fair amount evaluation versus historical cost evaluation

This example aims at emphasizing the influence the change in accounting evaluation base has upon entity performance, namely fair amount evaluation versus historical cost evaluation.

Thus, let us suppose an entity has a building it purchased on the date 01.01 of year N, with prompt payment at the price of 500,000 m.u. Its useful life is 10 years and its depreciation method is the straight-line depreciation method.

On the date 31.12 of year N, according to the information on the market prices of buildings in the same class as the ones it has, the company may decide whether it will book-keep the historical costs of its buildings or it will change the evaluation base.

The entity decides the revaluation of all the buildings it has and resorts to the services of a company specialized in evaluation activities in order to set the fair value of the building at the revaluation date. Since the real estate market is facing major price fluctuations, the company requires the evaluator to re-estimate the building's fair value in the end of each year.

The valuator provides the following information: the fair value at the date 31.12 of year N is 530,000 m.u. and the fair value at the date 31.12 of year N+1 is 470,000 m.u. These amounts have been found by the method of market comparison. Due to the fact they are market values, the enterprise decides to choose the method of revaluation entry at the net value.

The implications upon the company's profit and loss account by renouncing the historical cost model in favour of the fair value model are the following:

1. The depreciation during financial years N and N+1 calculated by comparison to the historical cost is: 500,000 m.u. / 10 years = 50,000 m.u./year

2. The calculation and entry of differences ensuing after revaluation at the date 31.12 of year N by the method of net value:

Table no. 1

	Fair value at evaluation date	530,000 m.u.
-	Books value at revaluation date Historical cost – Accumulated depreciation = 500,000 m.u. – 50.000 m.u.	450,000 m.u.
=	**Positive difference after revaluation**	

	(plusvalue)	80,000 m.u.

By entering this positive difference after revaluation, the building is book-kept and shown in financial statements at its fair value of 530,000 m.u. In addition, the value of depreciation expenses reported in the profit and loss account will be set by comparison to this fair value.

3. The recalculation of annual depreciation by reference to the fair value at the date 31.12 of year N:

Annual depreciation = Fair value / Remaining useful life = 530,000 m.u. / 9 years = 58,888 m.u.

4. The calculation and entry of differences ensuing after revaluation at the date 31.12 of year N+1 by the method of net value:

Table no. 2

	Fair value at evaluation date	470,000 m.u.
-	Books value at revaluation date Fair value at previous revaluation date – Accumulated depreciation = 530,000 m.u. – 58,888 m.u.	471,112 m.u.
=	**Negative difference after revaluation (minusvalue)**	**1,112 m.u.**

The depreciation value reported in book-keeping during the following financial year is 470,000 m.u. / 8 years = 58,750 m.u.

After admitting the revaluation effects, the building will be book-kept both in current accounting and in financial statements at its fair value of 470,000 m.u. If one supposes the real estate market has meanwhile become steady and the company will not require any revaluations during the next two years since value fluctuations are not significant, the submission in financial statements will prospectively take place starting from this fair value.

In the following, there are the effects of the evaluation base changes upon the profit and loss account for the financial year N+1.

Table no. 3

Profit and loss account	Traditional financial submission at historical cost		Fair value submission, method of net value	
	N	N+1	N	N+1
Total revenues	600,000	700,000	600,000	700,000
Total expenses of which:	150,000	230,000	150,000	288,888
Depreciation expenses	50,000	50,000	50,000	58,888
Financial year earnings	**450,000**	**470,000**	**450,000**	**411,112**

If one compares the information shown at historical costs with the one at fair values, one can notice the change in the assets' evaluation base impacts the profit and loss account as the earnings are affected by the change in the value of depreciation expenses.

The passage to the fair value evaluation model involves professional options and judgment. They intervene in order to set the revaluation rate so that the submissions in financial statements should take place at the fair value and also to set the useful life:

the changes occurring on the market of the respective asset may influence the decisions about how to exploit it and its useful life.

4. Conclusions

Accounting policies reflect a number of rules, conventions and practices used to lay down and report financial statements. The goals of choosing accounting policies differ from one company to another. There are companies that implement certain accounting policies in order to decrease their taxable revenues or decrease their losses or distributable profits, or they can apply policies that help them manage the information in order to develop a favourable opinion about the company so that to obtain new loans or attract new investors.

When deciding upon an accounting policy although the option for a method or another is generated by the 'need for truth', one cannot avoid the management concerns of an enterprise as the object of accounting reflection and tax charge. Thus, whereas a "true and fair view" involves providing the real data on inventories and earnings, a company should also pay attention to its management concerns when building the structure of costs meant to make it competitive, and also to its fiscal concern with minimizing the taxes it pays. In this respect, it should be mentioned that accounting norms allow various alternatives relating accounting entries and evaluations, having different impacts upon the company's earnings. Choosing one method or another should occur in reference to the fundamental goal of accounting which is the truth: real, correct and credible information to all users including the State.

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