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ESTIMATION OF THE BALANCE-SHEET ELEMENTS – ESSENTIAL REQUIREMENT IN ASSURING THE REAL IMAGE OF THE ENTERPRISE PATRIMONY AS OFFERED BY ANNUAL FINANCIAL REPORTS

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ABSTRACT. Towards the last decades of the 20th century there had been a considerable increase in the social role of accountancy, owing to the fact that the information it furnished influenced more and more the behavior of its users in the process of decision-making. Therefore, as a current accountancy final product, the financial reports represent the main source of information for a large range of users. They indicate the financial status and performance of an enterprise, so as to evaluate its capacity to furnish both cash and cash equivalents. All these financial statements are quantified by value, based on the principles and methods of valuation. The historical cost, prudence, the principle of stability for monetary unity and the on going nature of the operational activity provide the frame of valuation in the field of accountancy. Following the attributes awarded to accountancy and the principles which are associated to it, literature states the idea that accountancy information is a compromise which should allow for the presentation of faithful images of assets, debts, financial position and enterprise performance, correct and honest accounts. At the same time, it needs to respect a series of principles, among which those of valuation, monetary nominalism and prudence. All these have a determinant influence on the conception of 'faithful'/real image.
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1. Introduction

Valuation is the process by which values are determined; such values which describe elements in financial statements are shown by the balance-sheet and in the profit and loss account (Ristea and Dumitru, 2005).

Along the time, in the theory and practice of accountancy, there have been constituted three fundamental principles about how to evaluate assets, debts, equity, income and expenses as follows: *utility value*, *market value* and *the length of time.*

Utility value **–** is established depending on the market price, the utility of the goods, their condition and the place of distribution.

Market value – represents the price that can be obtained/paid in the direct transactions, on an active market, if the following three conditions are cumulatively fulfilled:

- market assets are relatively homogeneous;
- there are sufficient quantities of such transactional assets, in such a way that at any time potential buyers and sellers can be found;
- prices are available in order to be known by the public.

The length of time - may place the moment of valuation in: the past, the present or the future.

2. Faithful Image of the Economic Reality – The Reason for Valuating the Balance Sheet Elements is Essential

In relation to the nature of elements within financial statements, the sense of movement intervenes within the mass of the patrimony and the moment when valuation is made. According to the national accountancy regulations, and in conformity with European Directives, the following types of valuation are predetermined: *valuation at entrance point into patrimony management, valuation at exit point from patrimony management, valuation at the date of inventory and valuation in the balance-sheet.*

VALUATION AT ENTRANCE POINT INTO PATRIMONY – it is based on justified documents and gains the status of *entrance accountancy value*, which is identified through:

- *Utility value*, for the goods that entered as contribution in nature, that were gained with gratuitous title, or they were donned, and is established depending on the market price, the goods utility for the enterprise, its status and distribution. Such a value is assimilated to the costs of acquisition.
- *Cost of acquisition*, for the goods obtained with onerous title. The acquisition cost is made from the buying price, non-recoverable taxes, transport-supply expenses and other non-provided expenses, necessary for putting into function or entering into administration of the respective goods.
- *Production cost*, for the goods produced in the enterprise; the cost is made up from the acquisition price of the raw materials and consumed materials, direct expenses of production, besides quota of indirect expenses distributed rationally on the final product.

VALUATION AT EXIT POINT FROM PATRIMONY - when going out from the enterprise or at the moment of giving the goods to consumption, the goods is evaluated and they are subtracted at the initial value or the so called accountancy value.

If the goods, like the nature of stocks and securities, similar or identical, have different entering values and there is no possibility of identification for their entering values, the valuation at the moment of going out can be made, depending from case to case, on the ground of *medium average cost*, after the method *first-in-first-out* or after the method *last-in, first-out.* The criterion of choosing either of the mentioned methods is represented by *valuation clarity,* and the decision belongs to the management team.

Within the frame of the enterprise accountancy policy, the chosen method should be applied consistently from a financial period to another. If in exceptional situations, the administrators decide to change the valuation method, they must present explicit notes on the financial situations, the reason for modifying the method and their effects on the result of the financial framework.

In conformity with the principle of method consistency, the changing of the method intervenes at the time when it is imposed by the law or by the authority having regulatory powers in accountancy, and also in the case in which it is considered that this change will offer a real presentation of the patrimony and of the accountancy result within annual financial situations.

VALUATION AT THE TIME OF INVENTORY - has the right referee *actual value*, which gains the status of *inventory value* of the patrimonial elements, evaluated when their inventory is being made. The actual value is established in function of goods utility in enterprise and the market price.

The valuation of the balance-sheet elements at the inventory value starts from the necessity to update the entrance value, grounded on the historic cost. Any significant change which takes place after the goods entered patrimony tends to make the initial cost extremely difficult to ascertain for users of such information.

VALUATION IN THE BALANCE-SHEET- supposes the comparison of the inventory value with the entering value of the patrimonial elements, from which can result differences, which are treated differentially.

Thus, for assets, in the case in which the entrance value is greater than the inventory value, it is appreciated that there exists an irreversible depreciation of these and, as a consequence a *harmonization* or a *regulation for depreciation* is used in accountancy. If there are surpluses between inventory value (greater) and entering value (smaller), these are not going to be registered into accountancy, the assets being maintained at the entrance value, grounded on historic cost.

For liabilities such as debts, the differences concluded as surplus between the inventory value and their entering value, are registered by accountancy based on the corresponding elements of debts, through commissions.

The main reason of valuation, pursued by any accountancy system, is that of presentation of a real *image* of the economic reality. The principle of the real image, applicable at the international level has the purpose to get qualitative characteristics of financial information, namely: *intelligibility, relevance, credibility, comparability.*

Intelligibility - the information should *be easily* understood by users who have sufficient knowledge regarding business, economy and accountancy and have the desire to study seriously the information presented in the financial documents.

Relevance - The information is relevant when it influences users' economic decisions helping them to evaluate the past events, present or future, and in this way the prior valuation is validated or corrected.

Credibility - The information should not contain significant errors and it should not be biased, aspects which are realized through a loyal presentation of the enterprise's economic image, through the priority of the economic on juridical, neutrality, prudence and intelligence.

Comparability - The information should be presented in a consistent way over the time, respecting the accountancy principles of valuation, in such a way that can permit the users to make significant comparisons between the data regarding the enterprise's activity from different periods, and also between enterprises which have the same profile.

The real image of economic reality raises valuable problems of valuation within accountancy and can be discussed only in relationship with four out of the fundamental accountancy principles, respectively: *historic cost, monetary nominal* (stability of the monetary unit), *exploitation continuity* and *prudence.*

The principle of historic cost and *monetary nominalism*. Historic cost, also known under the name "principle of the original cost" is a modality of application of *the monetary nominal principle* and consists in conserving the entering/historic values at the level of financial situation structures. In other words, the assets, debts and proper capitals are registered into accountancy at the original cost (entering cost), registered in the justifying documents. These values are corrected with write-offs or regulations on depreciations. Relied on the hypothesis of the stable monetary unit, the principle of the historic cost consists in respecting the nominal monetary value, without taking into account the variation of its buying power.

The principle of operation continuity creates a vision on economic entities, according to which it is supposed that it continues as normal, to function into a foreseeable future, without entering into liquidation status or a serious slowing down of the activity. This principle does not automatically suppose permanency. The enterprise will continue to be a long enough period of time, in order for the objectives and activities within the constituted act to be achievable and the engagements/contracts assumed to be respected. Also in the view of this principle, the period of enterprise exiting is supposed to be longer than the useful period of life of its actives.

Prudence principle – consists in precautious appreciation of the assets value, debts and proper capitals, expenses and incomes, in order to avoid super valuation of the result. According to the prudential principle it is not admitted the super valuation of debts and incomes, respectively sub-valuation of the assets and expenses, taking into consideration the depreciations, risks and possible loses, generated by the activity development of the current or previous financial framework. Thus, the risk of transfer into the future of the present uncertainties is avoided; uncertainties which may tax the patrimony and the results of the enterprise.

The use of the historic cost as a background for valuation supposes that the currency value of the goods, facts and phenomena maintain constantly during an administration period. Although the practice invalidates stability because currency changes its value (buying power), with plus or minus, from a period to another, and because contemporary economic environment is confronted with a multitude of risk and uncertain factors, with an impact on strong monetary instability.

3. The *Just Value* versus *Historic Cost* in the Balance Sheet Valuation

Within the conditions of monetary unity depreciation, the qualitative characteristics of the financial–accountancy information are diminished through historic cost utilization, because there seems to be some lack of information regarding the real buying value. In other words, accountancy information regarding the buying power at the entering moment, expressed in historic costs, becomes then, incorrect and falsified. This phenomenon determined the identification of some new *ground evaluating bases* which permit the presentation of the accountancy information in the buying power of the monetary unit at the moment of utilization (current cost).

Framed in the ’80s, in the United States of America and other Anglo-Saxon countries, one of the valuation forms, used more and more in accountancy language, is that of *just value*. The Council for Accountancy International Standards has introduced the notion *just value*, in the year 1995, through IAS 32, with reference to financial instruments: *just value represents the price at which an asset could be transacted or deduced a debt between two competent parts, having no dependent link between them and acting in full liberty.* At the same time one can notice that the just value corresponds also to *market value which establishes the price that the seller could get (or the price that the buyer could pay) for a financial instrument, transacted on an active market. (International Accounting Standards Committee*. Bucharest: Economic Publishing House, 2000 – IAS 32, 708).

Both definitions of the just value correspond to a valuation made at a given moment with the difference that the first appears in the context of a transaction negotiated freely, while the second supposes the existence of an organized, active market.

The notion of just value was introduced for the first time into Romanian Accountancy Norms through Order of the Ministry of Finance no.94/2001 and through Orders of the Ministry of Public Finance no. 1752/2005 and no. 3055/2009, through which there were approved Accountancy Regulations in conformity with European Directives. The norm elaboration regarding utilization of the *just value* contributes to the passing from the valuation of *historic cost* to valuation of *just value*.

Historic cost presents, in comparison with other valuation bases, a series of *advantages*, but also *limits*. A valuation in historic costs has the guaranty of being reliable because historic costs can be verified and are considered to be objective. So being established, historic cost remains fixed, as long as the goods are in enterprise possession. In order to rely on information provided, the internal and external users should be self assured that the information is exact and based on facts. That is why the use of the historic cost, as a fundamental means of measurement, permits to provide objective and verified information into financial documents.

On the other hand, for external users of the financial documents, the cost offers also other non-contested qualities: reliability, prudence, continuity and precision.

With all its advantages, the valuation of historic costs within conditions of inflation, leads to a series of deformations in financial documents. Thus, *in balance-sheets* sub-valuations of fixed assets and stocks appear, having impacts on distorting the net situation and in the *profit and loss account* the material cost and expenses regarding liquidation are sub-dimensioned, as a consequence of sub-valuation of stocks and fixed assets, having implications in increasing the profit tax, by sub-estimation of the result.

Accountancy should not be limited only to provide retrospective information, based on historic costs, regarding financial position and enterprise performances, but should also permit foreseeing because the environment in which it activates is based on time irreversibility and non-certainty.

In order to answer all these requirements, the valuation model called *just value* was introduced. Its application in the last decade was more and more extended, owing to the development of the capital markets. The utility of the goods valuation at their *just value* unfolds from its capacity to provide the users financial information regarding the *future treasure fluxes*. In other words, the valuation at the just value gives possibility to the users to know the value of the goods according to what they will “bring/produce” in the future.

By comparing what is missing in accountancy systems based on historical cost with valuation at just value, it is possible to find the following advantages of using the just value, namely:

- *high flexibility* – valuation within historic cost, which is very rigid, while the just value is more flexible.
- *coherence of administration of financial risks* – the just value is adapted to financial risk administration, through which economic reality can be reflected more faithfully.
- *foreseeing* – the just value represents the best ground for foreseeing the future financial fluxes, and it is based on these estimations.
- *integrality* – the just value permits total the accountancy of the values. Through application of the historic costs there were registered by accountancy only elements which had a cost, while financial derivate products, not being registered by accountancy, were not taken into consideration for evaluating the future cash-flows.
- *neutrality* – it derives from the fact that the just value requires external data from the enterprise, being not influenced by its management.

Valuation is not an exact method. Most evaluating processes express opinions and, in this way, the valuation modalities generated great divergence among specialists.

Proponents of the evaluating methods based on historic cost consider this variant as being more relevant because it is focused on the results of buying/selling assets or contracting/paying debts, while information in just values, with a focus on the market prices, is less relevant because it reflects the effects of transactions and the events in which the enterprise did not participate directly.

The proponents of the evaluating methods based on the just value appreciate that in an instable economic environment important changes occur within short periods of time and in this way, valuations based on historic cost lead to distortion of the financial information. In this sense, the traditional model of valuation based on historic cost, doubled by application of the prudence principle, suffers vehement critics on one hand, for approximate / subjective estimations, referring to depreciation of the assets, and on the other hand, for dependence of estimations at different levels on the interest of accountancy representatives.

The authors of these critics sustain as a counterweight the virtues of the just value, which lead to more objectivity and more neutrality because this accountancy evaluating model is protected from *influences* and *opportunism* present at many account representatives, and as a consequence, represent a way of protection against tendencies of falsifying the images rendered through financial documents.

Being a stake for different social protagonists, *the truth rendered through the real image* of a patrimony and the results from financial documents should be found in accordance with the producers and users' interest. The truth, provide by accountancy, cannot be for users but the result of a *compromise between expectations and exigencies*, and for producers, *a concession between sincerity and regularity* (respect for principles and fundamental regulations).

Establishing a background for valuation represents one of the most difficult problems in the accountancy field. At present, the valuation of assets, debts, proper capitals expenses and incomes is made on the base of historic cost. The option for historic cost is based on the fact that it is the only cost written in justifiable documents so that it has a verified character and an objective calculation, being valid within the frame of the transactions developed on the market.

With all its advantages within the inflation/deflation periods, registration and presentation of the assets, debts and proper capitals, historic cost is intensely criticized, mainly when the variation of prices is very high, since this leads to deformation of the reality and implicitly of the information presented in the synthesis documents.

In this context, in later years, the idea to account certain balance-sheet elements circulates more and more, and these elements could be fixed assets, at the estimated value of future treasury flows that they can bring to the entity and not at the historic cost. In other words, in order to present the value of an asset, there is a tendency towards evaluating the future incomes rather than the past expenses, through consequent valuation at the just value.

7. Conclusion

Indifferent to the divergence that could arise among specialists regarding the ground of valuation, respectively advantages and limits, in the opinion of accountants, *respecting the accountancy principles, the regulations and methods of valuation is sufficient for a real image.* As a consequence, the accountancy legislators consider that the strict application of the regulations, accompanied by producers' sincere informing, satisfy the objective of *real image*. Within this sense *regularity* consists in respecting the norms, regulations and procedures pervaded by accountancy legislation, besides those which are not integrated in the normative documents, but they are in professional use, and *sincerity* is synonym with authenticity, respectively with the absence of a distorted image of the enterprise, presented in the financial document.

With all these, starting from the limits of the accountancy principles and valuation methods, information producers have the possibility to provide the financial information having in consideration a certain result of the previously established financial framework. Within this purpose different techniques are accessed:

- *Super-valuation/sub-valuation of some assets positions,* whose values are appreciated in accordance with the costs. So, "arrangement" of the costs within administrative accountancy leads to different results;

- *'Cosmetics' of the annual or intermediary accounts,* aiming at the quota of the Stock-Exchange value, through sub-valuation of the debts and super-valuation of the profit.

- *Provisions* - the negative influence of the historic cost on super-valuation of the results is diminished. Through the perspective of the faithful image, fundamental objective of accountancy, provisions represent a means of treating on value level the existence of uncertainty in valuation of assets and results.

Many enterprises work with provisions only on the condition in which they are fiscally deductible. In this sense, time can be transformed into an opportunity for regulating the result, through the technique of creating provisions at the present moment, when expenses increase and reconsidering them in the future, when the incomes rise.

- *Fiscal facilities* represent a modality of arranging the results, within conditions in which the accountancy system is based on passing from accountancy result to fiscal result. All fiscal facilities determine the enterprise to integrate them into accountancy and, as a consequence, to the "calculation" of the accountancy result.

- *Transfer price between the component enterprises of the group* - increased or reduced in relationship with the interest of transferring the benefit of a society in the favor of another. As a general practice it is preferred the transfer of the benefit from a country with excessive fiscal-taxation into another country with a relaxed fiscal-taxation.

The prices of transfer are also practiced in the case of internal circuits of enterprise's operation, in the case of intermediary consumptions, determined by the production transfer from a factory to another, from a section to another, having as a consequence the acceleration or delaying of the transfer of expenses on the result of financial framework.

Subjective increasing or diminishing of incomes and expenses represents another "arrangement" technique of the accountancy result. In this direction the delimitations between financial periods act, and they regard expenses and revenues, proved by anticipated delivery of the goods, which can be achieved only after the ending of the financial period, as well as different ways of registering the unfinished production and the on going works from a long term contract.

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