

RECOGNITION AND ASSESSMENT IN ACCOUNTANCY

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Abstract:

The recognition and assessment of the component elements of the annual financial statements' structures is crucial in order that the information released by them fulfils the qualitative characteristics and the reflected image is a "true and fair view". Therefore, our approach takes into consideration the recognition and assessment methods for the component elements of the financial statements' structures, as well as certain possible risks arising from the erroneous recognition or non-recognition of some of these elements.

Key words: recognition, assessment

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According to the General framework for drawing up and presenting the financial statements prepared by IASB an asset is "a resource controlled by the entity as a result of certain past events and from which future economic benefits are expected for the entity".

Two conditions are retained from this definition, namely:

a) the control over the entity's resources;

An entity has the control over an asset if it has the ability to obtain future economic benefits from its use and if it may restrict the access of others to those benefits. In the context in which the entity can prove, through estimates, the existence of future economic benefits attached to the assets, it is allowed to have control over the resources held.

b) the existence of future economic benefits;

This criterion refers to the ability with which the assets contribute to the cash flow and cash equivalents towards the entity.

The assets of an entity include the fixed assets and the current assets, each having several structures. The fixed assets are represented by: tangible assets, intangible assets and financial assets.

The international accounting standards define tangible assets as those assets that:

a) are held by an entity to be used in the production of goods or performance of services, to be rented to third parties or to be used in administrative purposes;

b) are used for more than one year.

From the above-mentioned definition tangible assets have the following characteristics: they are used repeatedly for at least one year; they are purchased in order to be used in operating activities, they are not intended for the sale to customers.

According to the International Accounting Standard 16 "Tangible assets" and to the Order of the Ministry of Finance 3055/2009 for the approval of the accounting regulations compliant with the European Directives, with the subsequent amendments, it is considered that the delineation of the tangible assets is done in the following categories:

a) land and land improvements;

b) tangible assets, classified in:

1. constructions;

2. technical equipment, vehicles, animals and plantations: technological equipment, devices and systems for measurement, control and adjustment (machinery, working installations and equipment); means of transportation; animals and plantations.

3. furniture, office equipment, protective equipment for human and material values and other tangible assets.

Tangible assets are recognised by an entity when:

- they generate future economic benefits to the entity;
- the cost of the asset can be credibly measured.

If we discuss the individual recognition of the tangible assets, we can mention that: an asset is recognised as a tangible asset according to the International Accounting Standard 16 “Tangible assets” when the following conditions are met:

- a) it is held for use in the production of goods or performance of services, for rental to third parties or to be used for administrative purposes and
- b) it is likely to be used during more than one period.

To achieve the first condition the asset must be owned by the entity and the asset must have one of the following destinations: production of goods; performance of services; hiring to third parties and use for administrative purposes.

This condition raises some questions because the entity must estimate the extent of certainty of the future economic benefits flows based on the existing bookkeeping upon recognition. It is therefore necessary to identify whether the asset will contribute directly or indirectly to generating cash flows and at the same time the entity must assimilate both the benefits and the risks of this asset.

In order to achieve the second recognition condition it is necessary to use the asset for more than one year, on several exercises.

This criterion does not generate difficulties because both in the case of the purchase and in the case of direct labour achievement, the acquisition cost or the production cost of the assets acquired can be measured objectively, according to the documents owned by the entity.

The delineation and recognition of the individual assets is up to the entity, taking into consideration the regulations in force, the experience of the financial statements’ “preparatory,” his/her objectivity, simply to avoid the risk of their erroneous classification with implications on how they will be recovered in the future.

The following clarifications are made on the recognition of group tangible assets:

There is the risk that in practice the first criterion for recognizing the assets cannot be fulfilled because the economic benefits generated by the individual asset may be missing, benefits that may be independent of the cash inflows from other assets or groups of assets. In this case, the entity shall identify and recognise the smallest group of assets that includes the individual asset and generates cash input from their common use, inputs that are largely independent from the cash inputs from other assets or groups of assets.

The general background for the presentation and reporting of IFRS financial statements and the accounting regulations in Romania mention that tangible assets shall use the following assessment bases: historical cost, current cost, feasible value and updated value.

The most commonly used assessment basis by the entities is the historical cost, sometimes combined with other assessment bases. Some entities use the current cost as a consequence of the failure of the accounting model based on the historical cost to solve the problems related to the effect of change in the non-monetary assets pressures.

From a fiscal standpoint, the increase in the value of fixed assets after re-assessment generates an increase in harmonisation and in the amortization costs automatically generating a decrease in the income taxes.

According to the International Accounting Standard 38 “Intangible assets”, an intangible asset is a non-monetary asset, identifiable, without material support, held for the use in the production or supply of goods or provision of services, for rental in administrative purposes.

The category of intangible assets has the following structure: setting up costs; development costs; concessions; patents; licenses; trademarks; commercial estate; advances to suppliers of intangible assets; intangible assets in progress, other intangible assets.

Not all the items that could be classified as intangible assets meet the recognition criteria of an intangible asset, thus there is the risk of non-recognition. In case the item does not meet the recognition criteria, it is necessary that all expenses for this item are recognised as current expenses in the income and loss account.

We have mentioned earlier that it is necessary for an asset to meet the following criteria in order to be recognised as an intangible asset: identifiability; control over a certain resource; the existence of future economic benefits and establishing the cost.

The assessment of intangible assets upon the entry in the entity is made to the original value under the form of: production cost, acquisition cost and utility value. However there is a risk of an erroneous assessment of the intangible assets. That is why it is necessary to know the regulations in force and their proper application, precisely in order to avoid such risks.

IAS 1 “Presentation of financial statements” refers to the fact that an entity shall classify an asset as current assets when:

- it is expected to capitalise the asset, or it is intended to sell or to consume it within the normal operating cycle;
- the asset is primarily held for transactions;
- the asset capitalisation is expected within twelve months after the reporting period, or
- the asset represents cash or cash equivalents (as defined by IAS 7 “Cash Flow Statements”), unless there is a restriction that the asset be modified or used to settle a debt for at least a twelve-month period after the reporting period.

The category of current assets includes: stocks, receivables, short-term investments, pay office and bank accounts.

According to the International Accounting Standard 2 “Inventories” and the Order of the Ministry of Finance 3055/2009 for the approval of the accounting regulations compliant with the European Directives, as subsequently supplemented and amended, the stocks are active:

- owned for sale in the normal course of business;
- being produced for sale in the normal course of business;
- under the form of raw materials, materials and other consumable items to be used in the production process or to perform services.

The definition presented emphasises three criteria according to which the stocks are classified and delineated in financial accounting as follows: physically (the tangible and intangible type of stocks), destination (their use) and the operating cycle phase (purchasing, production, sales).

According to these criteria the following structures are delineated: raw materials; consumable items; materials such as inventory items; semi-finished products, end products and residual products; young animals, animals for fattening; birds and colonies of bees; production being manufactured; goods and the like, reusable transport packaging.

A fourth criterion classifies stocks in: stocks located at the entity’s warehouses; under supply stocks or arrived and not-received; incoming stocks without invoice;

stocks delivered but not invoiced; invoiced stocks but not delivered; stocks located at third parties.

The International Accounting Standard 2 “Inventories” states that stocks should be assessed at the lowest value between cost and the net achievable value.

The recoverable value is represented by the cost of the stocks considered to be unrecoverable if the stocks were either damaged or were wholly or partly technically obsolete or their selling prices were decreased.

According to the International Accounting Standard 2 “Inventories” the cost of the stocks comprises all the acquisition and processing costs, as well as other costs incurred in order to bring the stocks to the form and place where they are today.

Therefore, the following costs can be mentioned as specific to the stocks assessment: acquisition cost; processing cost; historical cost.

The prices used in the assessment of the current assets are called registration prices, prices that may vary depending on the preference of the entity and on the nature of the stocks and of the production in progress, as follows:

a) raw materials, consumable items, inventory items, packaging may be reflected in accountancy in the acquisition cost, in the standard price or in the billing price of the provider;

b) the production in progress, the semi-finished and finished products, the inventory items, the packaging and the other goods produced by the entity, in direct labour, are reflected in accountancy in the production cost or in the standard price;

c) the animals and birds are reflected in accountancy in the acquisition cost when they are purchased outside the entity or at the production cost when coming from own production.

Moreover, stocks assessment is achieved in the four moments:

- upon entry into the entity;

Assessment and registration of the stocks upon entry in the patrimony is carried at the historical cost, which can be identified according to the case through: either the acquisition cost or the production cost.

- during the inventory;

The assessment and registration rule of the stocks upon inventory is achieved at the current value or the utility one, also called the inventory value.

- upon the balance sheet;

Assessment at this moment is done at the entry value, respectively the accounting value in agreement with the assessment results upon inventory.

- upon exit from the entity.

At this moment stocks are assessed using one of the following methods: the weighted average cost method; the first entry-first exit method; the standard cost method; the specific identification method (in accordance with IAS 2 “Inventories”, FIFO and CMP are considered basic accounting treatments).

The International Accounting Standard 24 “Related party disclosures” stipulate that a relationship with the related parties can have an effect on the financial position and on the results of the entity. The provisions of the same standard must be applied upon identifying relationships with the related parties and transactions with the related parties, such as the unsettled amounts or situations in which these issues must be reported.

In the category of settlements with third parties all the receivables and the debts to the third parties are delineated on a short-term settlement.

The short-term receivables are considered economic values temporarily advanced to other natural or legal persons who are to receive an equivalent value.

Their recognition requires the fulfilment of two criteria, namely:

- the likelihood of a future economic benefit (the case of assets) or of an outflow of resources having economic benefits (the case of debts);
- assessment should be carried out reliably.

The assessment of these categories of assets represents the process that determines the values to which the current receivables and debts will be recognised in the financial statements. As common assessment bases we can mention: the historical cost; the current cost; the achievable value and updated value.

The general framework for the drawing up and presenting the financial statements issued by IASB states that “the elements directly related to the assessment of the financial position are the assets, the debts and equity”.

In terms of chargeability, capitals and debts are grouped into two categories:

- the permanent capital, consisting of: equity; technical provisions for risks and expenses; long-term debts;
- short-term debts, consisting of: debts with a settlement term less than a year or not exceeding one year and income in advance.

Equity is the shareholders' or co-partners' residual interest in the entity's assets after deducting all the debts. It includes the following structures: social capital, capital-related premiums, reserves, revaluation reserves, equity shares, gains or losses from the equity instruments, retained earnings and result of the exercise.

Due to the transactions made by the entity there are changes of the equity elements. In these circumstances, it is necessary that the changes occurred are recorded in the Statement of equity changes or in the Annotations. Nevertheless, there is the risk of failing to record, which results in distorting the loyal and complete image of the financial statements as a whole.

The use of accounting estimates is considered a beneficial process for the entity because it helps to anticipate the results, the proper recognition of the technical provisions and it does not diminish the credibility of the financial statements.

International accounting rules by Standard 37 “Technical provisions, debts and contingent assets” refer to the accounting of the technical provisions, debts and contingent assets.

The standard mentioned above states that “the value recognised as technical provision should be the best estimation of the costs required for the sinking of the current obligation at the balance sheet date”.

The estimation of the necessary costs to sink the existing debt represents the amount that the entity will pay to a third party at a given time.

The estimation of the results and financial effects is achieved depending on how the entity has analysed the current situation based on the similar transactions and the reports drawn up by certain independent experts. The assessment is considered the best method for estimating the debts.

According to Order 3055/2009, the technical provisions are intended to cover the debts whose nature is clearly defined and which on the date of the balance sheet are likely to exist, or are certain to exist, but which are uncertain concerning the value or the date on which they appear.

Technical provisioning should be done by taking into account the following criteria:

- technical provisions may not exceed the value of the debt for which they were formed;
- they are recognised when: an entity has a current obligation generated by a previous event; it is probable that an outflow of resources is required in order to meet the respective obligation and a reliable estimate can be made concerning the value of the obligation;

- obligations made by the previous events that have no connection with the entity's future actions are recognised as technical provisions;
 - technical provisions created as a result of certain losses from the operations are not recognised;
 - technical provisions are considered uncertain value and exigible debts.
- However, there is a difference between technical provisions and debts from commercial loans, acknowledged debts and contingent debts.

These are recognised when: the entity presents a current obligation due to the occurrence of an earlier event; it is probable that the outflow of resources will be required for the sinking of that obligation; a reliable estimate of the obligation can be made.

The contingent debt represents:

- a possible general obligation as a result of certain past events and whose existence will only depend on the occurrence of one or more uncertain future events;
- a present obligation that arises as a result of certain past events but which is not recognised.

When we talk about the notion of "contingent debts" we must make the following observations: the estimation of its financial effect; the occurrence of uncertainty related to the value or date of any outflow; the existence of the possibility of debt repayment.

The risks related to the technical provisions and contingent debts are generated because the administrators must make an estimate of these elements. Thus, risks interfere with the performance of the best estimate. Furthermore, the personnel involved in this accounting activity without having the right skills can lead to a wrong estimation of both the technical provisions and of the contingent debts.

We must also mention the fact that the estimate is made without an explanatory document, which leads to a series of risks for the financial statements users.

There is also a link between risks and the precautionary principle, namely that the risks may involve the increase in a debt's value, results and expenses incurred, but the professional accountant must take into account the precautionary principle in order not to overstate the elements of equity, debts and income, respectively not to undervalue the elements of assets and expenses.

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