ALTERNATIVE ACCOUNTING VALUATION TREATMENTS

TRATAMENTE CONTABILE ALTERNATIVE DE EVALUARE

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Abstract: *The current work sets out to bring forward the main approaches regarding the evaluation of financial structures. The different approaches can be grouped as follows: market based approach, which is based on the direct identification method and the cost percentage method; utility based approach, which is based on the updated value method and last but not least the cost approach, based on the historical cost method, me current cost method or the net realizable value.*

Key words: *evaluation, treatment, alternative, approach, methodology*

INTRODUCTION

The changes that have taken place in recent decades at the microeconomic level of the world economy have determined numerous difficulties regarding financial informing of investors, creditors and employees. All the fuss and murmur of capital markets have earned a venerable spot within the institutional framework of the world's developed economies, determining specialists to take into serious consideration the signals sent by the stock market, making them a real economic barometer in the diagnosis of each national economy.

Therefore, the internationalization of capital markets has determined investors and especially creditors, to exercise pressure on legislative institutions in order to construct a new methodology regarding financial reporting. Balancing solutions did not take long before being pushed forward, thus a large set of accounting policies and strategies have been shaped, meant to ensure a correct, clear and concise informing of the internal and external decision makers. Among the radical solutions that have been proposed is the use of alternative evaluation methods within the

process of evaluating the financial structures of synthetic financial statements.

MATERIALS AND METHODS

In order to piece together this study, multiple methods have been used concurrently as follows: comparative analysis, in theory as well in practice, synthesis, induction and deduction.

RESULTS AND DISCUSSIONS

The IASB framework defines evaluation as being "the process by which we determine the values within financial statements that will be recognized in the balance sheet and profit and loss account."[24] In accounting theory as well as practice, three criteria have been shaped regarding assets and liabilities evaluation: utility value, or real value; market value, which uses time as a price reference.

The utility value concept considers that the value must represent the "cost" or "sacrifice" incurred in order to obtain an asset, or what the asset would bring if the entity used it or sold it on the market. To this definition we can add the explanatory note that the utility value can also be viewed in light of the "loss" or "sacrifice" that the entity would incur if the respective asset would cease to exist.

The concept of "market value" is common within reporting accounting and enterprise evaluation missions. Due to the difference between each profession these notions have different nuances. At the same time, the deviation from the evaluation in market value of financial structures is underlined by the SEV 5 standard as well, "Entity evaluation," which underlines that "in some countries, an evaluator may be obligated to use or refer to a certain market value definition that meets specific legal or statutory criteria of the jurisdiction in which the evaluation services are being provided."

While SEV 4.03 defines "Market value" as being "the estimated amount for which a property (asset) may be exchanged at the time of the evaluation, between a decided buyer and seller, in a balanced transaction, after adequate marketing where each side acts knowingly of the facts, with prudence and without constraints," the IAS international accounting norms use an accounting concept similar to market value, representing the true

[24] IASB "Cadrul contabil conceptual", pct. 99.

value defined as "the amount for which an asset could be exchanged willingly between two parts that are in full knowledge of the facts, in a transaction with an objectively determined price."

Therefore, accounting data is far more useful to the entity's internal and external decision makers, and the much expected conciliation of the needs solicited in the evaluation and the accounting data offer is possible only if the emphasis is focused on the use of real value at a much larger scale, as a basis for the evaluation of financial structures and of synthetic financial statements.

Every single financial structure, in order to be recognized in financial statements, must cumulatively meet two criteria: it is likely that any future associated economic benefit will enter or exist in or out of the entity; the element has a cost or value that can be evaluated in a credible way.

The difficult problem that setters are being confronted with is that of insuring evaluation objectivity, due to some situations spoken of even within the conceptual framework of IASB, which supports the necessity of using rational and objective evaluation methods, "in many cases the cost or value must be estimated, the use of rational estimations constitutes an essential part in the elaboration of financial statements and does not influence their credibility."

The problem with evaluation is sparked by the chimeras of the value theory, generated by a considerable load of subjectivity when measuring the value of an asset, by looking at utility, or the quantification of a debt, given by the sacrifice cost that the entity is willing to pay. This is a short version of the evaluation process.

In order to pick an adequate evaluation method we will consider relevant and useful, in a synthetic form, the ideas of the value theory which are expressed by its postulates:

- Value is not an intrinsic feature of an asset or good, but it is created in the mind of the persons that constitute the market of that asset or good;
- Value is created by the interaction of four interdependent economic factors:
  - Utility, meaning the capacity of a good to satisfy a certain need or wish;
  - Rarity, which expresses the existence or the anticipation of supply for a certain economical good in comparison to the demand for that good;

- Ø Desire, expressed by the intensity of the satisfaction that an economic good will bring to someone who is not in possession of that good, but has great need for it.
- Ø Purchasing power, expressed by the capacity of an individual or group of individuals that are participants in the market, to buy the offered goods by means of cash or equivalent;

ü The show of value is conditioned by the transferability of the asset or good, expressed by its capacity to be exchanged for money or something equivalent;

ü The continuous interaction between the four economic factors is materialized in the action of the best known "law" of market economy, the law of supply and demand.

We will start this short incursion into the realm of evaluation basis, from the FASB conceptual accounting framework, which holds that "an asset, a liability and a variety of personal capitals must be measured in monetary units in a manner that's sufficiently reliable." In support of this goal, FASB proposes five different evaluation bases: historic cost, actual cost, actual market value, realizable value and last but not least, current value of future cash flows.

On the other hand, the IASB conceptual framework holds as a main treatment in evaluating financial structures, the method of historical cost, but also proposes a restricted set of alternative evaluation bases: fair value, used to evaluate all balance sheet items; evaluation based on inflation effects adjusting, as per IAS 29; reevaluation.

It's worth remembering that choosing the best method of evaluation for a financial structure is strictly related to the method of approaching the evaluation process. In this context, specialty literature mentions three such approaches: sales comparison approach, income approach and cost approach.

The market based approach is recommended in the case where there is an active market for the financial structure that is being evaluated. According to IASB, the definition of an active market is "a market where all of the following criteria is met: (a) the items being sold within the market are homogenous; (b) there will always be buyers and sellers that are interested; and (c) prices are available to the public."[25] In this context the recommended methods are: direct identification method which establishes the market value of an asset, by identifying with another asset, for which the selling price is already known; the method of cost percentage, which

[25] IAS 38, par. 7.

establishes a ratio between the selling price and the current cost of similar assets.

The income approach consists of allocating income directly to the evaluated asset. In this situation, the cash-flow method would be the most appropriate for evaluating the asset, by cumulating the updated value of future income that the entity would acquire by using it.

The cost approach is recommended in evaluating production that is currently being executed, when the status of production can be estimated by keeping in mind the proportion of each production stage in the total cost of production and the completion level of each stage. In this case the most adequate evaluation methods would be the historical cost method, the current cost method or the net realizable value method.

The process of perfecting the summary financial situations, although it will have to receive changes in the presentation format, would be insufficient in such an approach, because financial tweaks, regardless of the form of presentation that was opted for, would give birth to diverse methods for deforming the economic realities of an enterprise. Therefore, the problem with the endeavor to improve financial communication only comes to aid users in collecting and interpreting the content of the summary financial statements. The tough battle that the Romanian setters must fight against the resistance to change of the Romanian accounting culture is in the area of accounting strategies and accounting policies of reporting and registering or economical operations.

The state plays an important role in this open conflict, a state that has to understand more and more that the interference of the fiscal in accounting is never beneficial, not to the enterprises and not for the state either.

In order to become aligned with the dynamics of the economic system, the accounting system came up with a series of solutions that were meant to immortalize the economic situation of enterprises at a specific point in time, the most visible improvements having been recorded with the patrimony evaluation process. Thus, by using alternative evaluation methods, using evaluation bases that are much more connected to present evolutions and future tendencies, the myth of "historical cost" is slowly being left behind in favor of different concepts like "market value", or "present value of future benefits". In the last few years, all these evaluation bases, although they are still being used today, have been shadowed by a new perception of evaluation bases, by attributing more and more importance to the concept of "fair value." In order to give further clarification we will focus our attention towards a few such evaluation bases

that are the grounds of the alternative treatment: current cost, realizable value, and present value.

Current cost (CI) or replacement cost is the cost that the entity is willing to accept in order to acquire, at current value, a good similar to the one that is the object of the evaluation. The current cost of assets is the value in cash or cash equivalent that should be paid if the same asset or a similar one would be acquired or produced in the present, and the current cost of liabilities represents the value of the nominal sums that should be paid in order to get rid of the obligation in the present.

For example, in the case of inventory, the current cost is the price that should be paid in order to acquire it in the present. In the case of fixed assets the price is adjusted by the corresponding amount of depreciation. Even so, although the current cost is considered a solution for eliminating historical cost from the evaluation, unfortunately this as well has a large degree of subjectivity, taking into account that we are speaking of comparisons that the specialist should be making.

The realizable value (VR) consists of the value that the entity would receive if it would sell its fixed asset today under normal circumstances. For assets, the realizable value is equal to the cash value or its equivalent, which can be acquired by in the present by selling them normally. The realizable value can be equal to the gross realizable value, the net value, meaning the sale value minus the selling costs, the release (cession) value under normal conditions or with its liquidation value.

In her work[26], Lavinia Olimid points out the opportunistic perception of the financial value structures by pointing out that "the net realizable value is the true cost of holding an asset, the true sacrifice involved in holding the asset, because if the asset would not be held, its monetary equivalent could be used in other ways."

The present value (VA) represents an estimation at present time of the value, according to the fluxes of in future benefits that will appear with normal activity, more exactly, the bringing up to date of a value that will become available at a later time. In other words, it is a present value that is determined with the help of the future.

The present value, known also as the economic value, is determined by the actualization of future cash flows by a financial structure, representing inflow and outflow based on the nature of the structure being evaluated, as passive or active, according to the formula;

[26] Olimid, Lavinia, 1998, *Măsurarea rezultatului contabil*, Bucureşti, Editura Economică.

$$V_{ec} = \sum_{t=1}^{n} \frac{CF_T}{(1+i)^t},$$

where n represents the time the asset is being used, or the time it takes to pay off the debt, CF_t is the cash flows, and i is the discount rate.

It is especially Americans that that opt for this evaluations base most often, in order to be able to take into account the uncertainty that the entity is confronted with as well as the profitability of the activity.

CONCLUSIONS

The arbitration of evaluation bases is a hard mission for the ones responsible with supplying accounting data, although, the present tendencies indicate an obvious orientation, as an evaluation base, towards fair value, especially with investors.

The edifying factor regarding this is the point of view of the IASB, which claims, in its conceptual framework, that "because investors are susceptible to get risky capitals, the financial statements that answer their needs will answer to the majority of needs that other users susceptible to be satisfied by financial statements have."

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