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ACCOUNTING POLICIES EFFECTS ON DEPRECIATION AND EVALUATION OF BALANCE SHEET

Case Study

Keywords

*Accounting policies,
Accounting principles,
Evaluation,
Amortization*

JEL Classification

M40, M41

Abstract

In the actual context of accounting nomination and globalization, the requirement for information which reflects the reality and which allows comparison between time and space may be satisfied only by respecting the main accounting principles. These principles, together with accounting policies are the main elements which concur for obtaining a truthful image reflected in financial situations. The elements / items of financial situation are being evaluated according to the main accounting principles, being taken into consideration the limits of accrual accounting.

Starting from the diversity of principles and rules that exist within the accounting, this paper aims to form a main problematic frame concerning the principle of the method's constancy, whose purpose is applying the same registration, evaluation and presentation methods for operations, transactions, and balance sheet elements.

ASPECTS CONCERNING ACCOUNTING PRINCIPLES AND POLICIES

INTRODUCTION

The relations of modern society show that once with the development of free enterprise / market economy and the augmentation of its degree of complexity, the economical information must equally develop as area, content and efficiency, in order to be able to deliver elements necessary in taking decisions, for reflecting the exact entities' statement of assets and the results of economic and financial activity. (Pântea and Bodea, 2013)

For the increase of credential in a trustworthy image delivered by accounting, one must take into consideration many principles when organizing the entities' accounting. (Pântea and Bodea, 2013) Being resulted from practice, the background of principles modifies once with accounting practice and theory. There are created new principles, others tend to grow out of date, and not less are contradictory. (Ristea, 2007)

Among these main accounting principles, the one of consistency of methods destined to ensure the information's compatibility over time (Todea, 2009) has always kept its place and role in delivering a trustworthy image of the entity.

Accounting policies find concrete means of expression in the content of accounting norms and regulation, when the latter are applied for solving the upcoming problems raised by financial end economical reality. (Feleagă and Malciu, 2002)

Conceived and structured on a complex matter, namely the one based on respecting the accounting principles and policies, this paper aims to present these accounting elements from a theoretical and also a practical point of view, through a study case which reflects the effects of modifying these accounting policies related to the current financial exercise upon accounting records of tangible assets.

METHODOLOGY

The methodology I have used for realizing this scientific approach has at its basis a theoretical research concerning the concepts and regulations in this domain, accompanied by an empirical research. I have applied for studying financial accounting papers elaborated by famous authors, for analyzing the regulations in this field, thus creating an exploratory qualitative paper, but also I have applied for researching the practical aspects specific to the modification of accounting policies related to current exercise, thus being a descriptive quantitative paper.

Accounting policies are detailed methods of evaluation, measurement and accreditation that an entity chose from the ones generally accepted by law, accounting standards or commercial practices. These policies have to be permanently used and must be public. (Nobes, 1999) Indirectly, accounting policies are substantiated within the evaluated systems with the help of conceptual frame. (Feleagă and Malciu, 2002)

Accounting principles are those rules that guide the entity to deliver a trustworthy image by financial situations. A list of these principles covers: the principle of activity continuity, the principle of exercise independence, the principle of separate evaluation of assets and liabilities / active and passive elements, the principle of intangibility, the principle of non-compensation, the principle of economical over juridical prevalence and the principle of relative importance. (Stan and Anghel, 2007)

This paper presents certain aspects concerning the principle of method permanency. This principle is also known as the principle of fixism. The coherence and the compatibility of accounting information involve / imply both constancy when applying accounting rules and procedures of evaluating the patrimony, and also presenting them in financial statements. (Pântea and Bodea, 2013) By this requirement it is ensured comparability in both time and space for financial statements's information.

The constancy of methods is relevant only if in an accounting system there is the possibility of choosing a method of evaluation or registration from more possible versions / variants. (Todea, 2009)

ASPECTS CONCERNING ACCOUNTING POLICIES MODIFICATION CONCERNING DEPRECIATION AND EVALUATION OF BALANCE SHEET ELEMENTS

Choosing and applying accounting policies must be made on one hand only by taking into consideration the conformity with the standards and legislation in this domain, and on the other hand one must choose the most relevant accounting treatment for the users of financial situations.

According to IAS 16, the redemption is the systematic allotment of depreciable value of an asset in its total lifetime.

From an accounting point of view, redemption represents the decreasing value of an asset as a result of depreciation through using it by the entity, and from a financial point of view it is a source of auto financing. (Ristea, 2007)

Evaluation is considered to be a procedure of accounting method, meant to ensure a trustworthy and complete rendering of patrimony, of financial situation and of the results obtained by the enterprise. In this regard, evaluation is considered the operation, by which the size of patrimonial elements or the patrimony itself is quantified in a natural expression and then this size is presented with the help of value or monetary gauge. Concerning reevaluation, this means to evaluate again, usually updating a preexistent value.(Todea, 2004)

Order 1802/2014 points out accounting policies which refer to: choosing the method of assets' depreciation, tangible assets reevaluation, or keeping their historical cost; recording on the period in which the tangible assets are passed into preservation, of an expense with the redemption or of an expense correspondent to adjusting the ascertained depreciation; choosing the method of stock evaluation, stock accounting through permanent or intermittent inventory etc.(OMFP 1802/2014)

Modifying in accounting policies are permissible if asked by law or by having as a result more credible and relevant information concerning the operations of an entity.(Coman, 2009) A series of situations which justify the modification in accounting policies refer to: entity's stock and shares admission of transaction in a regulated market for a short period of time, or retreating them from transaction, shareholder's change due to his entering in a group, if the new methods ensure supplying more accurate information, merging and division performed at accounting values, and in this case it is required that the countable policies of the absorbed company to be redeemed to the absorbing company. (OMFP 1802/2014)

Any change of accounting policies must be mentioned in an explanatory note, for the users to be able to appreciate the effects that the change has upon the reported results, the real tendency of the entity's results or choosing new appropriate accounting policies. (Coman, 2009)

According to OMFP 1802/2014 the following are not considered changes in accounting policies: applying an accounting policy for transactions, other events or conditions that are basically different from the previous ones, respectively applying a new accounting policy for transactions, other events or conditions which previously took place or were insignificant. One must take into consideration that the initial appliance of tangible assets policy must be treated as a reevaluation.

The effects of modifying accounting policies related to previous financial exercises are registered based on the reported result (account 1173 "Reported result originated in accounting policies changes"), if the effects of the change may be quantified, and contrary, the change of accounting

policies is made for future periods of time, starting with the current financial exercise and continuing with the following financial exercises. Concerning the current financial exercise the effects of accounting policies changes are booked on the basis of expense accounts and incomes resulted in that period. (OMFP 1802/2014)

Alongside the effects of modifying the accounting policies, one must take into account the effects of modifying an accounting estimation. According to OMFP 1802/2014, these are prospectively conceded by their inclusion in the result of the period in which the change takes place, if this affects only the respective period, or in the result in which the change take place for future time, of the modification has effects upon this period too.

STUDY CASE CONCERNING THE EFFECTS OF MODIFYING ACCOUNTING POLICIES ASSOCIATED WITH THE CURRENT FINANCIAL EXERCISE REFERRING TO DEPRECIATION AND EVALUATION OF BALANCE SHEET ITEMS

Case 1: The entity S.C. EXAMPLE S.A purchased 7320, machinery at the beginning of the period for which it was established the linear depreciation mode, and the established effective service time was 6 years. The machinery was used in a new manufacturing area of the entity, and as a result of closing the financial exercise, it was established that the machinery digressively consumed itself. It was decided that the linear method of depreciation to be changed to the digressive one, and concerning its service life, this was reduced from 6 years to 5. The used digression coefficient was 1,5.

Registration of machinery purchase

%	=	40%	Assets	8784
2131	"Technological	suppliers"		7320
equipments				
(machines,				
machineries	and			
work installations)				
4426	"Deductible			1464
VAT"				

Registration of expense of annual depreciation

6811	"Operating	=	2813	"Depreciation	1220
expenses	of installations and				
concerning	means				of
assets	transport"				
depreciation"					

Calculating annual depreciation according to linear method: $7320 / 6 = 1220$ lei

Modifying the depreciation method represents a change of accounting policies used by the entity, which will be booked according to OMFP 1802/2014 in the expenses associated with the

financial exercise for purchasing the machinery, and the reappraisal of useful service life will affect both the depreciation which is specific for this financial exercise, and the one of the following years.

Recalculating depreciation considering the digressive method and the 5 years service life:
 Linear rate = $100/5 \text{ years} = 20\%$
 Digressive rate = $20\% \times 1.5 = 0.3$
 Annual depreciation = $7320 \times 0.3 = 2196 \text{ lei}$
 Depreciation extra calculation = $2196 - 1220 = 976 \text{ lei}$.

When closing the financial exercise, the supplement of depreciation will be registered into accounting.

6811“Operating expenses concerning assets depreciation”	=	2813“Depreciation of installations and means of transport”	976
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Information provided with explanatory notes:
 At the end of the financial exercise, the entity decided to change the depreciation regime of certain machineries from the linear to the digressive one. This decision was made in order to give more relevant and reliable information. The decision was based on the fact that the machineries digressively consumed. The useful service time was also changes from 6 to 5 years. This change affected the depreciation expenses which were registered into accounting.

The effects upon financial exercise in reports refer to:

- depreciation expenses related to the financial exercise increased with 976 lei;
- accounting value of tangible assets decreased with 976 lei;
- the result of financial exercise is lowered with 976 lei in gross size, and with 819.84 (976 lei – 156.16 lei) lei in net size.
- the debt concerning the income tax is lower with 156.16 (976 lei x 16%) lei

Case 2: The entity S.C. EXAMPLE S.A. purchased for 31 lei a package of securities on short term, represented by 264 titles. In the year following the purchase, the securities’ issuer was accepted for trading at BSE, thus, the titles’ stock tare at the end of the financial exercise is 37 lei / piece.

The issuer’s admission to trading implies that the titles should be evaluated at their fair value and not at the historical cost, as initially reflected into accounting.

According to OMFP 1802/2014 this situation is not considered to be a modifier of accounting policies, but it is about a change of economical conditions,

of appearance of events and conditions which did not take place in the beginning.

Also, initial reevaluation is not considered a modifier for accounting policies. The question of modifying accounting policies arises in the case when the reevaluated value goes by historical price.

Case 3: The entity S.C. EXAMPLE S.A owns an installation purchased at the cost of 164800 lei, linearly depreciated in 10 years. During its normal period of functioning the next operations take place, for which the net method of register the differences in reevaluation is applied:

1. By the end of the second year, the installation will have been reevaluated, and the fair value of 152600 lei will have been established by an authorized assessor;

Cost = 164800 lei
 Annual depreciation = $164800/10 = 16480 \text{ lei}$
 Cumulated annual depreciation = $16480 \times 2 = 32960 \text{ lei}$
 Net accounting value = $164800 - 32960 = 131840 \text{ lei}$
 Fair value = 152600 lei

It may be observed that the fair value (152600 lei) is higher than the net accounting value (131840), thus it is registered a favorable difference of 20760 lei.

The next operations take place:
 Discharge of cumulated depreciation from gross value

2813„Equipment discharge”	=	2131		32960
			„Equipments”	

Registering positive difference from reevaluation

2131	=	105	„Reserves from reevaluation”	20760
„Equipments”				

Calculation of annual depreciation, after reevaluation:
 Fair value / remaining life service = $152600 / 8 = 19075 \text{ lei}$

Registering the depreciation

6811 „operating expenses concerning assets’ depreciation”	=	2813		16480
			„Equipments depreciation”	

Registering reserves from reevaluation

105	„Reserves from reevaluation”	=	1175	„The reported result represents the redundancy from reevaluation reserves”	2590
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$19075 - 16480 = 2590$

2. At the end of the fourth year, the installation will be reevaluated, and the fair value of 100804 lei will be established by an authorized assessor

Cumulated annual depreciation = $16480 \times 2 = 32960$ lei

Accounting net value = $152600 - 32960 = 119640$ lei

Fair value = 100804 lei

It may be observed that the fair value (100804 lei) is lower than the accounting net value (119640), and as a result it is registered an unfavorable difference, a depreciation of 18836 lei.

The following operations take place:

Elimination of cumulated depreciation from the gross value:

2813	=	2131	32960
„Equipment discharge”		„Equipments”	

Registering depreciation from reevaluation

%	=	2131	<u>18836</u>
105 “Reserves from reevaluation”		„Equipment”	15600
655 “Expenses from reevaluation the tangible assets”			3236

Due to the fact that the depreciation resulted from the second reevaluation is higher than the existent value in the reserve account of reevaluation, it is registered on expense of 3236 (Reserves from reevaluation 20760 – 2 x 2590 the reserve which is considered profit).

Calculating the annual depreciation, after reevaluation:

Fair value / remaining life service = $100804 / 6 = 16800$ lei

Registering the depreciation

6811 „Operating expenses concerning assets’ depreciation”	=	2813	16801
		„Equipments depreciation”	

3. At the end of the sixth year, the installation is reevaluated, and the fair value of 72400 lei will be determined by an authorized assessor.

Cumulated annual depreciation = $16801 \times 2 = 33602$

Accounting net value = $100804 - 33602 = 67202$ lei

Fair value = 72400 lei

It may be observed that the fair value (72400 lei) is higher than the accounting net value (67202 lei),

and as a result it is registered a favorable difference of 5198 lei.

The following operations take place:

Elimination of cumulated depreciation from the gross value

2813	=	2131	33602
„Equipment discharge”		„Equipments”	

Registering the positive difference from reevaluation

2131	=	105	„Reserves from reevaluation”	20760
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Calculating the annual depreciation after reevaluation

Fair value / remaining life service = $152600 / 8 = 19075$ lei

Registering the depreciation

6811 „Operating expenses concerning assets’ depreciation”	=	2813	16480
		„Equipments depreciation”	

Registering the reserves from reevaluation

105 “Reserves from reevaluation”	=	%	<u>5198</u>
		1175 „Reported result representing the realized profit reevaluating reserves”	1962
		755 „Incomes from reevaluating intangible assets”	3236

Due to the fact that the increased value resulted from the third reevaluation, is higher than the value existent in the expenses account, an income of 3236 lei is registered.

During the seventh year, the entity decides to change the politic of evaluation, thus passing from the reevaluation method to the cost method.

Annual depreciation calculation, after reevaluating, during the seventh year:

Fair value / remaining service life = $72400 / 4 = 18100$ lei

Registering the depreciation

6811 „operating expenses concerning assets’ depreciation”	=	2813	16480
		„Equipments depreciation”	

Registering the reserves from reevaluation

105 “Reserves = 1175 „Reported 1620
from result
reevaluation” reevaluating
reserves”

18100 – 16480 = 342

At the end of the year, entity registers

105 “Reserves = 2131 342
from „Equipment” 15600
reevaluation”
1962 – 1620 = 342

Starting with the month of January of the eighth year, once with the passing at the new method, the one of cost, it will be recalculated the corresponding amortization.

The remaining amortized value $55578 (72400 - 342 - 16480) / 2$ years remaining service time = 27789 lei / year

Information provided in the explanatory notes:

During the financial exercise, the entity decided to change the evaluation method of some installations shifting from the reevaluation method to the cost method. This decision was made in order to provide more reliable and relevant information. The enactment of the new policy has no effect upon the previous financial exercise.

The effects that it has upon the following financial exercise are:

- the expenses concerning amortization related to the financial exercise are higher 9689 lei
- the accounting value of intangible assets is lower 9689 lei
- the result of the financial exercise is lower 9689 lei in gross size and 8138,76 (9689 – 1550.24 lei) in net size
- the debt for income tax is lower 1550,24 (9689 lei x 16%) lei

CONCLUSIONS

Reflecting a trustworthy image through financial situations may be realized only by respecting the rules and norms in effect, by ensuring information which rever its qualitative characteristics which refer to its intelligibility, relevance, credibility, comparability, verifiability and neutrality.

The comparison of information both in time and space is possible only by using the same methods of recording and elements evaluation and accounting transactions.

Any change of accounting policies must be made only when it is asked by law or, when its purpose is offering more reliable information. Also any change that occurs and the effects of this change

must be stated in the explanatory notes of the financial reports.

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