ACCOUNTING METHODS AND PROCEDURES AMONG TRUE AND FAIR VIEW, MANAGEMENT INTEREST AND FISCAL INTEREST

Associate Professor, Ph.D. Dorina LUȚĂ
"Constantin Brâncoveanu" University of Pitești, Romania
E-mail: dorina_luta@yahoo.com

Abstract: *The article below is my intention of addressing some important issues regarding the role of accountancy as the main provider of economic information to business entities, and taxation as a system designed to collect taxes, fees and contributions through a specialized body. Business entities operate in an accounting system connected to or disconnected from taxation which can influence managers' decisions. The accounting policy is elaborated and assumed by an entity's management based on accounting principles. When determining an accounting policy, although the choice of one method or another is generated by the "need for truth," the entity's management interests as an object of accounting reflection and taxation cannot be avoided either.*

Key words: *accounting policy, choice, accounting principles, management interest, true and fair view.*
JEL Classification: *M41.*

1. Introduction

Business entities' activity aims at the following main goals: to make a profit and to meet the needs of a certain group of buyers. Failure to achieve either of the goals even temporarily may lead to their disappearance from the market. Additionally, it must take account of the conditions of the environment where it operates. In this context, accountancy must fulfil its mission as main provider of economic information, its main objective being to present: "a true, fair and full view" of an entity's financial status and performance, in line with the principle of neutrality, of the truth imposed by economic and financial facts.

To a shareholder or a partner as owner, a company means an investment, and the information they expect is to maintain their ability to finance the amount they have invested.

Accounting information is useful in making future decisions for the company so that the business entity management can ensure business development, profitability, profit growth, value added analysis, self-financing ability.

2. A true and a fair view

A *true and fair view* of a financial status or statement is the ratio between the assets, liabilities and equity of a business entity, as reported in its balance sheet. Information about the economic resources controlled by the business entity and its past ability to modify those resources is useful in order to anticipate the ability to generate cash or cash equivalents in the future.

The information about financial structure is useful for the application of certain accounting policies that allow the observance of sound management principles when using funds; when anticipating future lending needs; how profits and cash flows will be distributed among the stakeholders within a business entity as well as when estimating the chances of the business entity to receive any financing in the future.

Another important issue is the entity's liquidity and solvency. Liquidity and solvency information is useful for anticipating the entity's ability to meet its outstanding financial commitments. Liquidity refers to its cash availability in the near future, after taking account of the entity's financial obligations related to the period. Solvency refers to its cash availability for a longer period of time during which outstanding financial commitments are to be met.

The performance of a business entity represents its management focus and aims at: cost effectiveness, efficiency and efficacy.

For one thing, one should not overlook the fact that business entities operate in an accounting system connected to or disconnected from taxation, which can influence the decisions of managers. Unlike accounting rules, tax rules are not subject to the presentation of a true and fair view of business entities, but rather aim at promoting or impeding certain activities.

An accounting policy is drafted and assumed by the management of an entity based on accounting principles. In an economy which is disconnected from taxation, the adopted accounting policy can more easily satisfy the provision of true accurate information which by certification is credible for all users and, according to the fundamental accountancy objective meet the need for truth. In regulated accountancy, the accounting policies and procedures are based on both accounting principles and a normative regulation system. The reference system for the preparation of accounting policies accepts alternatives regarding accountancy-related registration and evaluation, namely different methods of evaluation and calculation of financial outcomes and statements.

When laying down an accounting policy, although the choice for one method or another is promoted by the "need for truth", the management interests of the entity as an object of accounting reflection and taxation cannot be avoided either. Thus, while a "true and fair view" involves providing a true financial statement and outcome, the entity must also monitor its management focus when achieving its cost structure that will make it competitive, along with its fiscal interest in minimizing the taxes paid.

Starting from such facts, one can estimate that from the perspective of a "true and fair view", business entities must take account of the irreversible or reversible impairment of various assets in order to present a true financial statement and outcome. However, reporting the impairments implies affecting expense accounts which will set the cost of production, so that reporting an impairment becomes an important lever in determining the accounting result. Moreover, taxation only partially recognizes depreciations and not at all impairment adjustments as being deductible, thus influencing taxable amount in its favour, with implications for the "true and fair" presentation: increased tax liabilities and the treasury that must bear an oversized tax.

It is found that the reporting of asset depreciation can be a conflict of interests considering the management and fiscal interests, with repercussions upon the true and fair view. Under such circumstances, starting from the limits of accounting principles/conventions, accounting information producers can resort to various ways to "shape" a financial statement and an accounting result until "distorting" them. The practices used in this respect are elegantly formalized under the name of "accounting policies", "outcome adjustment policies".

However, accountancy as a science, as an art in the economic decision-making gives the lawful possibility to choose the variant that best satisfies the company's interest without affecting the goal of attaining a "true and fair view" of the financial statement, status, and profit and loss account.

In the event of an irreversible impairment, legislative regulations on the methods for depreciating depreciable assets may have a significant impact on financial decisions regarding the investments of economic operators, given that, along with its market "competitiveness", investment interest must be a permanent concern when adopting an accounting policy.

It can be said that, due to the tax benefits generated by the depreciation policy adopted by an entity, under the prerogative of the legislative framework, it can improve the foreseeable profitability of investment projects. The benefits that could ensue from adopting a certain depreciation policy are closely linked to the favourable tax effects it generates. Choosing a certain depreciation regime under the same financing conditions has a different effect on the profitability of investment projects.

Below are the advantages that a depreciation method brings to an entity with higher expense rates in the first years – the accelerated depreciation, the degressive method compared to the linear method.

Example: On 1.01.N, S.C. Alfa S.A. has new equipment worth 2000 thousand Lei, with the duration of operation of 5 years. In order to compare the data, it is assumed that every year the entity raises a gross profit of 1200 thousand Lei before the depreciation inclusion, the profit tax rate is 16% and every year, the profit is distributed as dividends in the proportion of 40 %, with the remaining percentage at the entity's disposal for development.

Comparative Analysis of Depreciation Methods at S.C. ALFA

Thousand Lei

Years	Linear depreciation	Accelerated depreciation
1	400	1,000
2	400	250
3	400	250
4	400	250
5	400	250
Total	2,000	2,000

Economic calculation is made per each year.

Economic calculation for the first year is:

Thousand Lei

No.	Indicator	Linear depreciation	Accelerated depreciation	Conclusions
1	Gross profit before depreciation inclusion	1,200	1,200	
2	Depreciation	400	1,000	
3	Gross profit after depreciation inclusion (3=1-2)	800	200	
4	Profit tax (4=3*16%)	128	32	96 tax saving
5	Net profit (5=3-4)	672	168	
6	Self-financing ability (6=5+2)	1,072	1,168	
7	Dividends distributed (7=5*40%)	269	67	102 dividend saving

It can be seen that the total savings of the entity after using the accelerated method compared to the linear method is 198 thousand Lei. That money can be used by the entity to grow through new investments. In order to simplify this demonstration, one assumes that the resulting savings are deposited in a bank at a 28% interest rate per annum.

It results that after one year (in the end of the second year) the value of the accumulated capital will be 198*1.28 = 253.44 thousand Lei.

In the end of the second year, the economic calculations are:

No.	Indicator	Linear depreciation	Accelerated depreciation	Conclusions
1	Gross profit before depreciation inclusion	1,200	1,200	
2	Depreciation	400	250	
3	Gross profit after depreciation inclusion	800	950	
4	Profit tax	128	152	Additional payments of 24 thousand Lei
5	Net profit	672	798	
6	Self-financing ability	1,072	1,048	
7	Dividends distributed	269	319	Additional payments of 50 thousand Lei

Therefore, in the end of the second year, 74 thousand Lei are paid in addition (the accelerated method compared to the linear method). Those additional payments are made from the capital deposited with the bank. It results that, in the end of the second year, the balance remaining at the bank is 253.44 - 74 = 179.44 thousand Lei.

The calculations shown in the table for years 3, 4 and 5 are similar.

Year 3: Money accumulated in the bank: 179.44*1.28 = 229.68 thousand Lei; Additional payments: 74 thousand Lei

- Balance: 229.68 - 74 = 155.68 thousand Lei

Year 4: Money accumulated in the bank 155.68*1.28 = 199.27 thousand Lei; Additional payments: 74 thousand Lei

- Balance: 199.27 - 74 = 125.27 thousand Lei

Year 5: Money accumulated in the bank 125.27*1.28 = 160.35 thousand Lei; Additional payments: 74 thousand Lei

- Balance: 160.35 - 74 = 86.35 thousand Lei
- By using the accelerated method compared to the linear method, the entity raises 86.3 thousand Lei for those five years provided that the additional money raised in the first years is used efficiently, capitalized and not used for immediate consumption;
- The principle of a good finance specialist is confirmed: an entity must try to collect its receivables as soon as possible and negotiate the payment terms for its non-performing debts for as long as possible;
- For each depreciation method, the sum of the net profits raised and the self-financing abilities is the same, so that if the company does not efficiently use its savings obtained in the first year, it will not obtain overall positive results, except maybe the financing inability;
- The state budget collects the same tax, irrespective of the depreciation method used by an enterprise:
  - linear depreciation: 128+128+128+128+128 = 640 thousand Lei
  - accelerated depreciation: 32+152+152+152+152 = 640 thousand Lei.

The state budget collects less tax in the first year alone. Yet, by leaving a sum of money at the company's disposal, it basically finances company activity, waiting for it to develop, so that in the future the tax calculation base will increase, alongside increasing the budget revenues.

Regardless of the depreciation method used by a business entity, depreciation brings it new financing sources reflected in its self-financing ability, and if the depreciation methods with higher expenses are applied during the first years, it manages to create itself an economic advantage. Accelerated depreciation is particularly favourable for the entities that have to a lesser extent chose loan equity financing. The favourable effects of accelerated depreciation may also result from the positive impact on capital risk mitigation. Capital risk arises both due to uncertainty about the actual level of physical wear and tear, and to moral wear (for which subsequent technological innovations would also cause uncertainty about replacing the equipment).

Business entities must choose to set the useful lives, having the following possibilities: setting the useful lives of fixed assets in accordance with law no.15/1994; setting useful lives other than those provided in law no.15/1994. Assessing the normal service life must provide the entity with a structure of costs and tasks to make it competitive.

As regards the depreciable value from a tax perspective, it is interesting to highlight the assessment of fixed assets upon entry and their implications on the company's management. The inclusion or non-inclusion of expenses incurred purchasing and commissioning in the purchase cost or production cost may influence the tax outcome. Overestimating or underestimating the costs has direct implications for the "true and fair view" of a financial statement. Since the total cost elements are spread within various accounts, the former can be used for undervaluation or overvaluation, but especially for overvaluation in order to limit the importance of losses.

A (linear, degressive, accelerated) depreciation method is chosen according to the company's objectives, "aggressiveness" in approaching tax management and, of course, to the shareholders' decisions. It may be revised whenever it no longer corresponds to the manner in which a tangible asset in question generates future economic benefits.

3. Conclusions

Divergences between accountancy and taxation should be removed because the two meet in the same reality, with the economic entity being the main creator of wealth, and also the participant in the distribution of such wealth. Taxation must be interested in the stability of business entities, in their future, because their existence is linked to the achievement of its revenues. In a business entity, tax management aims at harmonizing the management and fiscal concerns in detecting divergences, for the benefit of the entity itself, for a true and fair view that will serve all users.

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