NATIONAL RECENT DEVELOPMENTS CONCERNING ALTERNATIVE EVALUATION RULES

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Abstract:
Under the current circumstances wherein the economic environment is influenced by increasingly fast and complex changes, having in view a required and expected development of Romanian market, the domestic firms will increasingly require financial tools. Consequently, their accounting, presentation and description of information related to individual or consolidated accounts and analysis of impact concerning their use over financial performances and position of entities are extremely hot topics for professional Romanian accountants, for which the issues approached in this paper are increasingly useful.

Key words: financial instruments, risks and advantages, fair value, revaluation

JEL classification: *M4, M41*

1. Introduction

For a better understanding and application of European directives, the Ministry of Public Finances considered necessary the elaboration of a new order of approving the accounting Regulations according to the European Directives OMFP 3055/2009 and approval of the Order of the Minister of Public Finances no. 1752/2005, with subsequent modifications and completions.

The most important modifications occurred to accounting regulations are: monthly evaluation of currency monetary elements, as well as of debts and liabilities, expressed in Lei, whose settlement is carried out according to the currency exchange rate, with acknowledgement in accounting of registered differences; correction based on the retained earning only of significant errors related to the previous financial years; accounting of financial leasing contracts, as long as only certain categories of entities may be lessee; approach of actual discounts, and received discounts respectively; application in accounting of the principle of economic issues prevalence over legal issues by all categories of entities; as well as application of alternative evaluation rules for tangible assets and financial tools.

The present article aims to present the main provision of the national standards related to the revaluation of tangible assets and fair value evaluation of financial tools.

2. Fair value evaluation of financial tools

By derogation from the general evaluation rules contained in the current regulations, entities may evaluate financial tools including derivate financial tools at fair value in the annual financial statement.

A financial tool means any contract that simultaneously generates a financial asset for an entity and a financial debt or an equity capital tool for another entity.

A financial asset is any asset that represents:

a) cash;
b) an equity capital tool of another entity;
c) a contract law:
- to receive cash or another financial asset from another entity; or
- to change assets or financial debts with other entity under circumstances potentially favourable to the entity; or
d) a contract that will be or can be settled in own equity capital tools and is:
- a derivate financial tool for which the entity is or can be under obligation to receive a variable number of own equity capital tools; or
- a derivate financial tool that will be or can be settled in a different way than through exchanging a fixed amount of cash or other financial asset for a fixed number of capital tools of the entity. To this end, the capital tools of the entity do not include tools that are contracts by themselves to receive and supply the own equity capital tools of the entity.

A financial debt is any debt representing:

a) a contractual obligation:
- to give in to other entity liquidities or other financial asset ; or
- to exchange assets or financial debts under circumstances potentially favourable to the entity; or

b) a contract that will be or can be settled in own equity capital tools of the entity and is:
- a non-derivate financial tool for which the entity is or can be constrained to supply a variable number of its own equity capital tools;or
- a derivate financial tool that will be or can be settled differently than through exchanging a fixed cash amount, or other financial asset in exchange of a fixed number of own equity capital tools of the entity. To this end, the own equity capital tools do not include tools that can be by themselves contracts to receive and supply the own equity capital tools of the entity in the future.

A derivate tool is a financial tool that meets the following requirements:
- its value changes as a result of variations as regards a certain interest rate, the price of a financial tool, the price of some goods, of a currency exchange rate, of a price index or a rate, a credit rating or credit index or other variable, on condition that, in case of a non-financial variable, this is not mentioned so a contract party (sometimes named the „base" or „backing element");
- it does not require any initial net investment or requires an initial net investment that is lower than that required for other types of contracts from which similar feedbacks to modifications of market conditions are expected; and
- is settled at a further date.

Examples of derivate tools are: binding forwords, swap contracts, futures contracts and conditional tools (purchased or sold options).

One of the characteristics of a derivate tool is it requires an initial net investment whose value is lower than that required in case of other contracts from which an identical feedback to market factors is expected.

The options is framed in the definition of derivate tools as the bonus paid, regardless the option is exerted or not, is lower than the investment that would be required to get the basic financial tool with which the option is correlated with.

In case of derivate tool contracts, their related purchase or sale commitments are registered in accounts outside the balance (account 8039- Other off-balance sheet items), when the contracts were concluded.

Generally speaking, the initial fair value of derivate tools is zero, except the options for which the initial fair value is provided by the value of the bonus paid or encashed, case when their value is emphasized in the debt accounts, and liability accounts respectively.

According to the Order of the Minister of Public Finances 3055/2009, call exchange operations are the purchase and sale operations of currencies, with settlement in the term generally through regulations or conventions of the market concerned, as usual maximum two workdays at the date when transaction was concluded, at the exchange rate set betwen parties (SPOT exchange rate).

The call exchange operations (FORWORD) are considered the currency purchase and sale operations, with settlement after the term set through regulations and conventions of the market concerned, as usual more than two workdays at the date of closing the deal, at the exchange rate set between parties (FORWARD exchange rate).

The SWAP operations are simultaneous purchase and sale operations of a currency amount, with settlement at two dates, with different values (as usual SPOT and FORWARD) at the setup exchange rates (SPOT and FORWARD) at the date of transaction.

As regards the present regulations, the contracts based on merchandise that provide to any contracting party the right of cash settlement or through other financial tools are considered derivate financial tools, except the cases wherein:

a) these have been concluded and continue to meet the expected requirements of the entity concerning the purchase, sale or use of the basic product;
b) these have been initially dedicated to such a goal; and
c) these are expected to be settled through merchandise delivery.

Fair value evaluation is applied to debts that are: held as part of a transaction porfolio or derivate financial tools.

Fair value evaluation does not apply to:

a) non-derivate financial tools held up to the due date;
b) loans and debts generated by the entity and not held for transaction; and
c) interests in subsidiaries, associated company and associations on joint account, capital tools issued by the entity, contingent payment contract within a combination of enterprises, as well as to other financial tools with such special characteristics and that, according to what is generally accepted, is accounted differently than other financial tools.

According to the current regulations, combinations of enterprises mean the grouping of some individual entities in a single reporting entity, driven by obtaining control over one enterprise or several enterprises.

The fair value is determined by reference to :

a) market value, for those financial tools for which an active market can be easily identified. If the market value cannot be easily identified for a tool, but it can be derived from that of its components or the similar tool; or
b) a value determined by means of some generally accepted models and techniques, for the tools for which an active market cannot be easily identified. Such models and techniques must secure a reasonable approximation of the market value and must be tested periodically (and revised, if need be) by comparing the values supplied with prices of noticeable actual transactions or based on any available market information.

Financial tools that cannot be evaluated credibly by means of any methods mentioned, they are evaluated in accordance with the general evaluation rules mentioned by the current regulations.

When a financial tool is evaluated at the fair value, the value modification is included in the profit and loss account. However, such a modification is directly included in the equity capital, in a fair value reserve, if:

a) the accounting tool is the cover tool against risks according to an accounting system of risk coverage that enable that some or all value modifications not to be recorded in the profit and loss account; or

b) value modification relates to a currency exchange difference occured at a monetary element that is included in a net investment of the entity in a foreign entity. Therefore, in consolidated financial statements that includ such a foreign entity, the currency exchange differences that in annual individual financial statements have been acknowledged in the profit and loss account, they are initially acknowledged in an equity capital component (account 1067- Reserves of exchange differences in relation to net investment in a foreign entity), following to be acknowledged in the profit and loss account at the assignment of net investment.

An enterprise can give in its interest in a foreign entity by sale, liquidation, return of capital stock or abandoning the entire entity or a part of it. A reduction of a book value of a foreign entity, either due to its losses, or due to a loss acknowledged by the investor, it does not represent a partial cession. Consequently, any part of earning or loss from exchange rate differences, delayed in equity capitals, is not acknowledged in the profit and loss account when the book value is reduced.

Considering the current regulations, the net investment in a foreign entity represents the value of reporting entity interest from the net assets of that foreign entity. A monetary element that is to be received from a foreign entity or paid to a foreign entity, for which settlement is neither planned nor is likely to be carried out in the near future, is ,basically, a part of a net investment of the entity in that foreign entity. Such monetary elements can include liabilities or long term loans. They do not include commercial debts and liabilities. The entity that has a monetary element to be received from a foreign entity or paid to a foreign entity, can be any group subsidiary.

The fair value reserve is adjusted when the amounts accounted in it are not necessary to apply the fair value evaluation.

The fair value reserve will remain evinced in accounting as long as their related financial tools are evinced in the balance.

If evaluation is applied to the fair value of financial tools, annotations present:

a) evaluation models and techniques are based on significant assumptions, if fair values have been determined according to the current regulations;
b) for each category of financial tools, the fair value, value modifications directly included in the profit and loss account, as well as the modifications included in the fair value reserve;
c) for each category of derivate financial tools, information concerning the area and nature of tools, including the terms and significant requirements that can affect the value, time and certainty of future cash flows; and
d) a table that presents modifications of the fair value reserve during the financial year.

3. Revaluation of tangible assets

Entities can revaluate the existing tangible assets at the end of financial year, so as they are presented in accounting at fair value, reflecting the results of this revaluation in financial statements carried out for that financial year.

The depreciation calculated for the tangible assets revaluated in this way is registered in accounting starting with the financial year following the financial year for which revaluation has been carried out.

Evaluations carried out on the occasion of enterprises' reorganizations (mergers, separations) does not represent revaluation considering the accounting regulations in accordance with European directives (OMFP 3055/2009), these evaluations being carried out in order to set the exchange rate, for all balance elements. Except situations wherein the date of financial statements that are the basis of reorganizations is the same with the date of annual financial statements.

If a completely depreciated tangible asset can be still used, on the occasion of its revaluation a new value is set for it including a new economic useful life, appropriate to the expected period to be used further.

In case when the revaluation of tangible assets is carried out, this issue should be presented in annotations, together with elements subject to revaluation, the method used in calculating the values presented as well as the affected element in the profit and loss account.

Revaluation of tangible assets is carried out at fair value at the balance date. The fair value is calculated based on some evaluations carried out, as usual, by evaluation qualified specialists, members of a body certified in the field, nationally and internationally certified.

As regards revaluation of a tangible asset, accumulated depreciation at the revaluation date is approached in one of the following ways:

a) proportionally recalculated with changing the gross book value of the asset, so as the asset book value, after revaluation, is equal to its revaluated value. This method is often used, in case when the asset is revaluated by applying an index; or

b) eliminated from the gross book value of the asset and net value, determined as a result of correction with value adjustments, is recalculated at the asset revaluated value. This method is often used for buildings that are revaluated at their market value.

In case when, subsequently to initial acknowledgement as an asset, the value of a tangible asset is determined based on the revaluation of the asset concerned, value resulted in revaluation will be assigned to the asset, instead of the acquisition cost/production cost or of any other value assigned before that asset. In such cases, the depreciation rules will be applied to the asset considering its value, determined following revaluation.

The elements within a group of tangible assets are revaluated simultaneously in order to avoid selective revaluation and reporting in annual financial statements some values that are a combination of costs and calculated values at different dates.

If a tangible asset is revaluated, all the other assets comprised in the group should be revaluated.

A group of tangible assets contain assets having the same nature and similar uses, and are in the operation of an entity. Examples of tangible asset groups are: land, buildings, cars and equipment, ships, aircrafts etc.

Revaluations should be carried out with enough regularity, so as the book value should not considerably differ from that determined using the fair value at the balance date. The fair value of tangible assets is generally determined, starting from their market value.

If an asset from a group of assets cannot be revaluated, for instance, as there is not an active market for that asset, the asset should be presented in the balance at the cost, minus accumulated value adjustments.

An active market is a market wherein the following conditions are met cumulatively :

a) traded elements are homogenous;

b) interested buyers and sellers can be permanently found; and

c) prices are known by the interested ones.

If the fair value of a tangible asset cannot be determined, the asset value presented in the balance should be its revaluated value at the date of the last revaluation, of which accumulated value adjustments are deducted.

In case when revaluation of tangible assets is carried out, the difference between the value resulted in revaluation and the historic cost value should be presented at the revaluation reserve, as a distinct element in „Capital and reserves" (account 105 - Revaluation Reserve). The fiscal approach of reserve from revaluation should be presented in annotations.

Whether the reserve value has been changed or not during the financial year, entitities should present the following information in the annotations:

a) Reserve value from revaluation at the beginning of financial year;
b) Revaluation differences transferred to the revaluation reserve during the financial year;
c) Amounts capitalized or transferred in a different way from revaluation reserve during the financial year, presenting the nature of any transfer, complying with legislation in force;
d) Value of revaluation reserve at the end of financial year.

The revaluation surplus included in the revaluation reserve is capitalized by the direct transfer in reserves (account 1065 - Reserve representing the revalution reserve surplus), when this surplus is an actual earning.

For the purpose of current regulations the earning is considered realized at taking out the asset for which the revaluation reserve has been established. However, a part of earning can be realized while the asset is used by the entity. In that case, the transferred reserve value is the difference between the depreciation calculated based on the revaluated book value and the value of depreciation calculated based on the initial asset cost.

If the revaluation result is a rise compared to the net book value, then this is approached as follows:

- As a growth of revaluation reserve presented within the element „Capital and reserves", if there was not a previous decrease acknowledged as an expense related to that asset; or
- As an income that compensates the expense with the decrease previously acknowledged to that asset.

If the revaluation result is a decrease of the net book value, this is approached as an expense with the entire depreciation value, when the revaluation reserve is not registered as an amount related to that asset (revaluation surplus) or a decrease of revaluation reserve presented within the element „Capital and reserves", with the minimum between the value of that reserve and the value of decrease, and a potential difference remained uncovered is registered as an expense.

The revaluation reserve should be reduced so far as the amounts transferred to it are not required to apply the evaluation method used to reach its goal as well.

The amounts representing differences as regards the nature of income and expenses resulted at revaluation should be presented separately in the profit and loss account.

None part of the revaluation reserve can be distributed, directly or indirectly, except the case when the revaluated asset has been used, case when the revaluation surplus is an actual earning.

Value adjustments are calculated in each financial year based on the value assigned to the fixed asset when that financial year is ended.

In case when revaluation is carried out, the annottations should present, the following information, separately from each element in the balance from the nature of revaluated tangible assets:

a) Historic cost value of revaluated fixed assets and the sum of value accumulated adjustments ; or
b) Value at the date of balance as regards the difference between the revaluation value and that representing the historic cost and, when necessary, the accumulated value of additional value adjustments.

4. Conclusions

The need to elaborate some standards related to finnacial tools, implicitly to assets and financial debts occured based on the burst of using the derivates and markets on which they are traded, as well as a result of many financial scandals that have shaken up the USA and Europe in the last decade. Among other reasons, they were caused by the inappropriate use of derivates and suppression of the disastrous effects of their poor management, by keeping them oustide the balance and not providing related information in the annottations of financial statements.

Incumbancy as regards presentation of derivates in balance as assets or financial debts and imposition of description concerning some detailed information related to financial risks, fair value, nature and contract requirements of financial tools, management policies of their related risks etc. are basic contributions to the accounting standards elaborated in this respect.

Accounting of financial tools and tangible assets according to the rules contained in international standards or in the national standards is completed by means of presentation and description of related information in the summary documents. Based on this information, certified by authors, interested users appreciate the impact of using financial tools over financial standing and performances of the entity and take economic decisions.

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