EFFECTS OF ENTERPRISE ACCOUNTING POLICIES REGARDING ADJUSTMENTS OF AN OUTCOME AND REVENUE TAX

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Abstract:
The effect caused by assets' impairment has imposed for an appropriate accounting evaluation the issue of finding certain mechanisms able to decrease or even cancel the distortion related to a historical cost. Keeping a historical cost as an evaluation basis, various corrective and alternative steps have emerged. Corrective steps have been taken in the form of value adjustments and impairments and alternative steps have been made while reevaluating the former. The accounting policy of an enterprise regarding adjustments has an influence upon the outcome of a tax year and, implicitly, upon a revenue tax by the impact of value impairment recognized as an expense of the period to the extent to which it is fiscally deductible.
In the countries where accounting is connected to fiscality, by the set-up of adjustments, enterprise pursue only fiscal advantages, not the requirements to reflect a "true and fair view'. Analyzing value adjustments only from the perspective of tax rules, due to their being non-deductible, enterprises which give up the mechanism of adjustments may obtain a distorted fixed asset capital, far from the accounting truth.

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An enterprise accounting policy referring to value adjustments influences the results of a tax year and implicitly a corporate tax by the impact of reversible value impairment also known as an expense of the reporting period to the extent to which it is fiscally deductible.

Although in commitment accounting, norms and principles admit the full entries of asset impairment thus leading to a "true and fair view" of an entity's status, fiscality imposes restrictive rules for the deductibility of impairment depreciations and adjustments.

If depreciations are admitted as deductible from the fiscal perspective, impairment adjustments are not accepted in any deductibility form, except for account receivables under certain circumstances set forth by the Fiscal Code.

Thus, there is non-compliance between the financial statements submitted by an enterprise and its true facts, which leads to a distortion of accounting information which is no longer real and credible.

Unfortunately, in the countries where accounting is related to fiscality, enterprises pursue by their provisions and value adjustments to have only tax advantages and not to meet the requirements to reflect a "true and fair view". With impairment adjustments regarded only from the fiscal perspective as they are non-deductible and with enterprises' giving up the mechanism of value adjustments, the latter shall raise a distorted fixed asset capital which is far from accounting truths.

In the following there are the financial and fiscal inferences regarding the set-up of adjustments starting from a hypothetical situation and taking account of the making up of both deductible value adjustments and non-deductible value adjustments.

Example: Here is a comparative analysis of two companies: SC ALFA SA and SC BETA SA, which have the same object of activity, namely manufacturing and marketing electric household appliances. In the end of accounting year N-1, in the beginning of tax year N respectively, the two trading companies have the same financial status and the same achievements. Therefore, the balance sheets of the two companies in the beginning of tax year N show the structure below:

Table no. 1

Balance Sheet in Early Tax Year N in SC Alfa and SC Beta

ASSETS	*AMOUNTS – Lei -*	*SHAREHOLDER DEBTS AND EQUITY*	*AMOUNTS – Lei -*
Fixed assets	20,000	**Debts**	**22,000**
Raw material stocks	7,000	- corporate tax	2,400
Finished products stocks	9,000	- dividends payable	11,250
Receivables from customers	8,000	- commercial debts	8,350
Bank accounts in Lei	16,000	**Shareholder equity**	**40,000**
Lei cash	2,000	- registered capital	30,000
-	-	- reserves	10,000
-	-	- tax year result	11,250
-	-	- profit distribution	11,250
TOTAL ASSETS	***62,000***	***TOTAL SHAREHOLDER DEBTS AND EQUITY***	***62,000***

The profit and loss account in the beginning of tax year N is as follows:

Table no.2.

Profit and Loss Account in the Beginning of Tax Year N in SC Alfa and SC Beta Companies

PROFIT AND LOSS ACCOUNT	*AMOUNTS -Lei-*
Revenues from sales	30,000
Revenues associated with product stock costs	7,000
Operating costs	25,000
Operating result	12,000
Financial result	1,650
Extraordinary result	0
Gross result of tax year	13,650
Corporate tax	2,400
Net result	11,250

The following economic operations were reported during year N:

- *acquisition of finished products amounting to 30,000 Lei, with purchase price for finished goods of 40,000 Lei, manufacturing cost associated with finished product sales of 25,000 Lei, of which only 30,000 Lei is collected and the remaining 10,000 Lei means receivables. A SC GAMA SA customer is declared bankrupt with a receivable of 4,000 Lei to be paid;*
- *total operating costs of 30,000 Lei, of which 29,000 Lei was paid and the remaining 1,000 Lei is a debt;*
- *revenues from charged interests of 2,000 Lei;*
- *dividends are paid during the year amounting to 11,250 Lei and a corporate tax amounts to 2,400 Lei;*
- *net profit in the end of the year is wholly allocated for the payment of dividends.*

Trading company SC ALFA SA shall set out value adjustments for doubtful contested debts with the amount 4,000 Lei, and it forecasts slight chances to recover its debts by the balance confirmation letters sent out in the end of the tax year upon the inventory of debts. Trading company SC BETA SA does not make up value adjustments.

In the accounts of company SC ALFA SA, an accounting entry associated with adjustment production is the following:

6814 *Impairment of current assets*	=	491 *Allowances for doubtful customers*	4,000 Lei

Consequently, during year N, the two companies had the same entries with the only one distinction related to adjustments for doubtful debts' impairment prepared only by SC ALFA SA in the end of the year.

In the end of financial year N, the profit and loss account and the balance sheet in the two companies had the following structure:

Table no. 3

Profit and Loss Account in the End of Tax Year N in SC Alfa and SC Beta

PROFIT AND LOSS ACCOUNT	*AMOUNTS -Lei-*	
	SC ALFA SA	*SC BETA SA*
➢ Revenues from sales	40,000	40,000
➢ Revenues associated with product stock costs	5,000	5,000
➢ Total operating costs of which:	34,000	30,000
• value adjustment-related expenses	4,000	-
➢ Operating result	11,000	15,000
➢ Financial result	2,000	2,000
➢ Extraordinary result	-	-
➢ Tax year result	13,000	17,000
➢ Corporate tax (16%)	2,080	2,720
➢ Net result	10,920	14,280

The amounts have been produced by analyzing original situations and operations that took place during tax year N by means of synthetical and analytical bookkeeping.

Table no. 4

Balance Sheet in Late Tax Year N in SC Alfa and SC Beta

ASSETS	*AMOUNTS - Lei -*		*SHAREHOLDER DEBTS AND EQUITY*	*AMOUNTS - Lei -*	
	SC ALFA SA	*SC BETA SA*		*SC ALFA SA*	*SC BETA SA*
Fixed assets	20,000	20,000	**Shareholder equity**	**40,000**	**40,000**
Raw material stocks	7,000	7,000	- registered capital	30,000	30,000
Finished products stocks	14,000	14,000	- reserves	10,000	10,000
Receivables from customers	14,000*	18,000	- tax year result	10,920	14,280
Bank accounts in Lei	5,350	5,350	- profit distribution	(10,920)	(14,280)
Lei cash	2,000	2,000	**Debts**	**22,350**	**26,350**
-	-	-	- corporate tax	2,080	2,720
-	-	-	- dividends payable	10,920	14,280
-	-	-	- commercial debts	9,350	9,350
TOTAL ASSETS	***6,350***	***66,350***	***TOTAL SHAREHOLDER EQUITY AND DEBTS***	***62,350***	***66,350***

** 14,000 is the net value of doubtful debts, 18,000 (face value) – 4,000 (adjustment for impairment).*

The financial and fiscal inferences of SC ALFA SA's making up of adjustments are the following:

- the profit of trading company SC ALFA SA which has prepared the adjustments for the impairment of doubtful contested debts decreased as against SC BETA SA, by 4,000 Lei respectively. It is justified by increasing entity expenses by the prepared adjustments which are fiscally deductible. Consequently, the profit goes down which shall result in the decrease of corporate tax. Thus, there is the delay of corporate tax payment relative of reporting period N, the period from its production until its cancellation;

– to SC ALFA SA, this delay of tax payment and the temporary custody by a business entity of a certain amount of net profit namely 4,000 Lei is a direct advantage.

– by liquidating company GAMA SA, once its assets have been valued and its debts have been paid, the following circumstances may arise for the two companies (Alfa and Beta):

• if the value of debts is recovered, the company registering adjustments shall cancel them relying on revenue accounts so that the payments which should have been made in the past (taxes and dividends) shall be made at present, which has made it possible for the company to receive free financing sources which somehow make up for the cashing delay. For the company which did not register adjustments, the subsequent recovery of debts did not influence it at all.

• if receivables are not paid, both companies shall have losses related to doubtful debts. For the company which has registered adjustments, their cancellation relying on revenues leads to the cancellation of loss effects from financial statements. For the company which has not registered impairment adjustments, the effects are felt only during the year of the failure to collect money, by including in the profit and loss account the expenses associated with losses from doubtful debts.

Once the dispute has been settled in a favorable or unfavorable way, the adjustment produced is cancelled:

491 *Allowances for doubtful customers*	=	7814 *Reversal of write-down of current assets*	4,000

In conclusion, the company shall have to pay 4,000 Lei more, either in the form of taxes to the state budget, or as dividends to be paid to shareholders. Under such circumstances, SC BETA SA shall practically not register any additional expenses but as compared with SC ALFA SA, it shall not benefit from the amount of 4,000 Lei that SC ALFA SA has been lent to for a period of two years at zero interest.

For the state budget, SC ALFA SA's preparing adjustments is not a direct advantage as they generate the delay of tax payment and therefore the delay of revenue collection by the state budget. Yet, the state budget shall have a long-term advantage due to SC ALFA SA's use of the amounts at its temporary disposal, it shall become more viable financially, it shall be able to improve its performance, its results shall be better and so it shall be capable of contributing in the state budget by a larger amount of taxes and fees.

These advantages become real only when the adjustments produced are fiscally deductible. The other value adjustments produced but not included in fiscal regulations are non-deductible from a taxable profit, so they shall be added in a taxable base to which a corporate tax is added. For this reason, business entities refrain themselves from preparing fiscally non-deductible adjustments even if the latter prove useful. Yet, their preparation emerges as a need for the purpose to reflect a true, fair view of business entities' financial statements.

It is appreciated that the value adjustments produced by business entities can at a certain moment represent conflict among several interests:

- **The state:** on one hand not interested in adjustment production (as adjustments delay taxes), but, on the other, the delay of such taxes leads to growing funds needed for the development and resulting in increased taxes to be calculated;
- **Partners and shareholders:** they are concerned both with the production of adjustments which indirectly lead to a better self-financing and with immediate earnings;
- **A manager:** s/he is not concerned with the production of adjustments, as s/he pursues positive results meant to satisfy the immediate requirements of partners (shareholders) and meant for publicity. Adjustment production under normal circumstances is not wanted as it can be a negative consequence to a certain extent of less inspired business;
- **An accountant:** s/he must show good will, pursue the reflection of this "true, fair view" producing adjustments irrespective of the interests existing at a certain time.

Adjustments are a necessity irrespective of whether an enterprise result is positive or negative. They are corrective reports which modify the results reached. These reports introduce much ambiguity in the term "result" when the term "perfect" is actually more adapted to designate them.

The verb "to perfect" has the following dictionary meaning:

- ✓ to purify, to make smoother, more delicate;
- ✓ to finish something;
- ✓ to cheat skillfully.

In the end of a tax year, an accountant is required to purify a result, to finish it somehow which does not exclude the temptation to cheat. It does not mean fraud, as a non-specialist might think. An enterprise manager assisted by his/her accountant must prove able to get integrated into legal and fiscal rules which all in all are rather permissive.

According to international financial reporting standards (IFRS) at world level, they provide the ascertaining of reversible impairment in all asset categories where such impairment can be ascertained. The standards referring to that are: IAS 36 "Impairment of Assets"; IAS 39 "Financial Instruments: Recognition and Measurement"; IAS 2 "Inventories".

The loss of value as regarded by international accounting standards is recognized as an expense for the reporting period and directly decreases the book value of an asset.

In practical terms, this approach changes the solid base of asset presentation at their historical cost. Yet, inferences are much more complex. For example, impairment adjustments make it possible to keep separate records (up to a certain level) of assets' "historical costs" and "market values" with the chance to return to origins at any time.

International practices used to ascertain the decrease in assets' value as against the practices in our country involve different variants to keep record of impairment.

The two methods of reporting asset impairment are shown in the table below:

Table no. 5

Reporting Variants of Asset Impairment

Romanian (current) variant		Foreign variant	
• Reporting the decrease in asset value: *"Adjustment expenses for asset impairment"*	*="Adjustments for asset impairment"*	*"Expenses for asset impairment"*	*= "Asset-related accounts"*
• Entry of value impairment cancellation: *"Adjustments for asset impairment"*	*="Adjustment-related revenues for asset impairment"*	*"Asset-related accounts"*	*= "Expenses for asset impairment"*

In both variants, in the loss and profit account one potential unfeasible expense is recognized when achievable value is lower than book value. Loss value is potential due to an asset's not being sold, consumed or transferred yet. Yet, no "potential earnings" are recognized which result when achievable value exceeds book value (principle of prudence).

The difference between the two variants is that in the international variant there is no necessary revenue recognized in a tax year in order to cancel a previous expense, but the original entry is reversed. Thus, calculating profitability indicators shall generate values. Moreover, an asset shall be shown in the balance sheet and basic records at its achievable value and the subsequent passage to expenses shall be done taking account of the new value.

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