APPLYING THE PRINCIPLES OF ACCOUNTING IN BANKRUPTCY PROCEEDINGS

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Abstract:
The application of accounting principles (accounting principle on accrual basis; principle of business continuity; method consistency principle; prudence principle; independence principle; the principle of separate valuation of assets and liabilities; intangibility principle; non-compensation principle; the principle of substance over form; the principle of threshold significance) to companies that are in bankruptcy procedure has a number of particularities. Thus, some principles cannot be applied to bankruptcy procedures (accounting principle on accrual basis, principle of business continuity, independence principle, intangibility principle and the principle of substance over form), some are available only in certain situations (method consistency principle and the prudence principle) and others do not apply to bankruptcy (the principle of separate valuation of assets and liabilities; non-compensation principle and the principle of threshold significance).

Key words: *accounting principles, bankruptcy proceedings, insolvency procedure, accounting policy, accounting*

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Introduction

For the organization and management of accounting in terms of European integration and alignment with the International Accounting Standards, the legislation in our country requires the compliance of the following principles (OMFP 3055/2009 article 20, paragraph. 3, pt. a): accounting principle on accrual basis; principle of business continuity; method consistency principle; prudence principle; independence principle; the principle of separate valuation of assets and liabilities; intangibility principle; non-compensation principle; the principle of substance over form; the principle of threshold significance.

„The legal framework of insolvency can be in agreement with the objective requirements of the transition economy only if it is harmoniously integrated within the system of national legislation, within the ensemble of rules for the economic activity” (Lepădat, 2010, p. 834).

Materials and methods

The research methodology was represented by the analysis and synthesis of the specialty literature and accounting regulations. Also, we used the comparison method between the conditions of application of each accounting principle in the two situations, namely the situation where the company under normal activity conditions, on the one hand, and with the application of insolvency proceedings, on the other hand.

Results and discussion

The application of all accounting principles in insolvency procedure isn't possible because they are applicable to entities whose activity is continuous, and not to entities that are subject to liquidation proceedings, therefore:

- ***The accounting principle on accrual basis*** assumes that the effects of transactions and other events are recognized when transactions and events occur (and not as cash or its equivalent is received or paid) and are registered in accounting and reported in the financial statements of the related period.

This principle cannot be applied in bankruptcy proceedings because collecting receivable payments and debt payments will be made in a period other than the reporting period in which they occurred, but the way they are registered and their reporting will be done at the time of production.

Incomes and expenses that result directly and simultaneously from the same transaction are recognized simultaneously in accounting through the direct association between expenses and associated revenues, with distinct presentation of these incomes and expenses.

The accounting principle on accrual basis is also applied to the recognition of the interest for the relating period, regardless of its maturity date.

- ***The principle of business continuity*** which implies that the entity continues to work normally in the foreseeable future without significant interruption or reduction. This principle implies (Trif V., Nagy C. M, 2009, p. 80) that the entity continues to operate normally, without going into liquidation or significant reduction in its activity. If the managers of a company are aware of some uncertainty elements related to certain events that may lead to its inability to continue its operation, these elements must be disclosed in the explanatory notes. If the annual financial statements are not drawn up based on the continuity principle, this information should be presented, together with explanations regarding how they were drafted and the reasons underlying the decision that the entity cannot continue its activity.

This principle is not applicable to entities that cease operation through liquidation under bankruptcy proceedings.

- ***The method consistency principle*** requires continuity regarding the application of accounting regulations and procedures, while ensuring comparability of accounting information. Changes of the accounting policy are allowed only if they are required by law, by an accounting standard or if they result in more relevant or reliable information regarding the entity's operation. Any changes of the accounting policy should be mentioned in the explanatory notes, for users to consider them: if the new accounting policy was chosen properly, the effect of the change on the reported results in the period and the real tendency of the results of the entity.

Examples of situations that justify the change of an accounting policy can be (Sabău, C., Trif, V., Artene, A., Nagy, C. M., 2011, p. 66-67):

- admission to trading on a regulated market of short term transferable securities of the entity or their withdrawal from trading;
- change of ownership, due to the entry into a group, if the new methods ensure the provision of more accurate information;
- mergers and similar transactions performed at book value, in which case it is required the harmonization of the accounting policies of the absorbed entity with the ones of the absorbent company etc;
- changes of the entity's management does not justify changes in accounting policies.

The application of the method consistency principle cannot be used in bankrupt companies because we can't apply the same methods since we are forced to perform evaluations and sales of assets given the liquidation, the price resulted from liquidation is not related to a particular sale method in terms of continuity, but it's established at the liquidation value determined by potential buyers.

- ***The prudence principle***, according to which the overstatement of assets and liabilities is not permitted, respectively the understatement of liabilities and expenses. For each value to be determined based on this principle, the following aspects will be pursued:

a) the profit and loss account can include only the profit achieved at the date of the balance sheet;
b) all liabilities incurred in the current financial year or the previous year should be taken into account, even if they become obvious only between the date of the balance sheet and the date of its completion;
c) all foreseeable liabilities and potential losses arising in the current financial year or a previous financial year should be taken into account, even if they become obvious only between the date of the balance sheet and its completion date. For this purpose, there should also be taken into consideration possible reserves as well as liabilities from contractual clauses;
d) all depreciations should be considered, regardless of whether the result of the financial year is profit or loss. The registration of adjustments for depreciation or loss in value is carried out in the expense account, regardless of their impact on the profit or loss account.

For financial statements to be neutral and have the quality of being credible, prudence does not allow, for example, excessive provisioning, deliberate understatement of assets or incomes, nor the overstatement of liabilities or expenses, because financial statements would not be neutral anymore.

The application of the prudence principle is required in bankruptcy proceedings when it is necessary to study the fiscal implications of tax incentives, provisions and other reserves required in the recalculation of budgetary obligations.

- ***The independence principle*** requires consideration of all incomes and expenses for the financial **year** for which the reporting documents are drafted, without taking into account the date when payments are collected or paid.

Thus, they will be highlighted in the incomes and receivables accounts for which no invoice has been made yet, respectively in expenses accounts or assets, the debts for which no invoice has been received yet. In all cases, the entry in these accounts is made based on the documents that certify the delivery of goods or services (for example, waybill notices, statements of work etc.) (Sabău, C., Trif, V., Artene, A., Nagy, C. M., 2011, p. 67-68).

This principle cannot be applied in the bankruptcy proceedings, because the bankrupt debtor draws up only two balance sheets, respectively when entering in bankruptcy and liquidation the balance sheet at the end of the procedure, which usually is not achieved at the end of financial year.

- ***The principle of separate valuation of assets and liabilities*** whereby a position where elements sum up several property elements, it shall be determined by taking into consideration all elements composing it, separately for assets and liabilities.

The application of this principle is also valid for companies that are in bankruptcy proceedings, whose balance sheet items must be evaluated separately.

- ***The intangibility principle***, according to which the opening balance sheet of a financial year must correspond with the closing balance sheet of the previous financial year.

Changes in accounting policies can be made only for future periods, starting with the next financial year following the one in which the decision to modify the accounting policy was made. Changes in accounting policies can be performed only at the beginning of a financial year. Modifications in accounting policies during the financial year are not allowed.

In the case of modifications in accounting policies and correction of errors relating to prior periods, the balance sheet related to the preceding period will not be changed.

The corrections based on the reported result and of significant errors related to previous financial years are not considered an infraction of the intangibility principle.

This principle is not applicable in bankruptcy proceedings since the opening balance sheet of the bankruptcy procedure will take only assets and liabilities inventoried eliminating non-values, since they cannot be used in this procedure.

- ***The non-compensation principle***, under which the value of assets cannot be compensated with the value of liabilities, respectively revenues with expenses, excluding the compensation between assets and liabilities accepted by the International Accounting Standards.

All receivables and liabilities should be recorded separately in accounting, based on supporting documents. Any compensation between receivables and payables against the same patrimonial entity, made in compliance with legal provisions, can be recorded only after accounting for incomes and corresponding expenses.

In case of exchange of assets, in accounting there is a distinction between the sales/output from records operations and the buying/input in records, based on supporting documents, with the registration of all incomes and expenses related to operations.

This principle can be maintained also in bankruptcy proceedings, the offset performed between customers and suppliers can only be achieved with the consent of a syndic judge.

- ***The principle of substance over form*** under this principle the presentation of values in the balance sheet and profit and loss account is made taking into account the economic background of the reported transaction or operation, and not only their legal form.

The compliance with this principle aims to record in accounting and to present fairly the economic and financial operations, in accordance with economic reality, emphasizing the right and obligations, as well as the risks associated to these operations.

Economic and financial events and transactions should be entered in accounting as they occur, based on supporting documents. The documents underlying the accounting registration of economic and financial operations should reflect precisely how they occur, respectively to be consistent with reality. Also, the contracts concluded between parties should provide the conduct of operations and comply with the existing legal framework.

In ordinary circumstances, the legal form of a document must be consistent with the economic reality. In rare cases, when there are differences between the economic background or nature of an operation or transaction and its legal form, the patrimonial entity will record in accounting these operations, in compliance with their economic background.

Examples of situations where the principle of substance over form can be considered: framing, by users, of leasing contracts in operating or financial leases; framing sales operations on their own behalf or commission sale or consignment; revenue recognition or expenses in the profit or loss account as income or expenses in advance.

Economic entities are compelled to account for economic and financial operations taking into account all available information, so as to avoid as much as possible the situations where the nature of the operation, determined based on the principle of substance over form, differs from that which would be determined without the application of this principle.

The principle substance over form cannot be applied to entities under bankruptcy proceedings, because through the legal character of transactions in this case is intended the removal of non-values and the valuation of tangible assets without taking into account the economic value of items.

- ***The principle of threshold significance***, according to which any element that has a significant value must be presented separately in financial statements and the elements with insignificant value that do not have the same nature and functions will be added up, since their separate disclosure is not necessary.

In exceptional cases deviations can be made from the general accounting principles set out in this section. Any such deviation must be disclosed in the explanatory notes, as well as the reasons that determined them, together with an assessment of their effect on assets, liabilities, financial position and profit or loss.

Applying the principle of threshold significance has no relevance in bankruptcy proceedings since the elements with insignificant values are not presented separately.

Conclusions

It can be concluded that the application of accounting principles is different in the case of companies in bankruptcy. Thus, from the ten accounting principles listed only three are valid in this situation, two may be applied only under certain conditions and five of them cannot be applied at all.

Given this situation, regarding the accounting of assets and transactions in companies in insolvency proceedings we must consider the possibilities of applying each accounting principle fully, partially, or not at all.

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