EVALUATION BASES IN ACCOUNTANCY

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Abstract: In specialty literature, the accounting evaluation is defined as the process which consists of the quantification and, on this basis, in measuring in a moneyed expression of the size of patrimonial elements and operations regarding the movement of these elements. Likewise, the evaluation represents that process of determining the moneyed value where the described elements in the financial situations are recognized and enlisted in the balance sheet and the profit and loss account. In this paper we propose a succinct characterization of the needle of that evaluation bases which can successfully enter the equation of reasonability and rationality: *historical cost, current cost, effectible value and updated value.*

Having as a study object the pursuance, reflection and control of size, existence and movement of means, processes and results, the accountancy uses at large scale the quantification as a *„procedure of accountancy method, by means of which it is established the size of objects, phenomena and economic processes, as well as the natural or conventional sizes, through which these sizes are expressed”* (Demetrescu, Possler, Puchiță, Voica, 1979, pp. 79), giving to this procedure the particular forms of evaluation and calculation, imposed by the characteristics of the accountant knowledge process. These forms, by means of which the quantification is made, in their application, interpenetrate so tightly, that, sometimes, nobody knows where starts or ends one of these forms and vice-versa.

In specialty literature, the evaluation is defined as the process which consists of the quantification and, on this basis, in measuring in a moneyed expression of the size of patrimonial elements and operations regarding the movement of these elements. The components of evaluation consider the object submitted to this operation and the moneyed standard as a measure unit and comparison. The object of evaluation represent the own structures of the patrimony and namely: the actives, the passives, the expenses and incomes, the economic results, as well as the economic and financial operations regarding the circuit of these structures. The moneyed standard consists of the calculation unit which allows the measuring, comparison and homogenization of the economic values.

Another definition of the evaluation describes it as being that process of determining the moneyed value where the described elements in the financial situations are recognized and enlisted in the balance sheet and the profit and loss account. This supposes choosing some certain evaluation basis. The general frame IASB formulates, in order to drawn up and present the financial situations, the accounting model evaluation reference based upon the recoverable historical cost and the maintaining concept of the nominal financial stock. It is a general model, which aims to even the path in the process of research of some other models and concepts which can be better adopted with the purpose of a better gratification of the main objective: that of providing useful information in the decisional process. The same general Frame provides that *„choosing* *the evaluation bases and the maintaining concept of the stock determines the accounting model used for elaborating the financial situations. The vary accounting models present different levels of relevance and credibility and, as well as in other fields, the management must look for an equilibrium between relevance and credibility".*

For the evaluation it can be used, depending on the case, only one evaluation basis or more mixed bases. We consider that ***the usage of more evaluation bases, in different combinations and usage levels, is salutary as we consider that any evaluation basis has a general validity and can not be entirely satisfactory.***

We shall proceed below to a review of that evaluation bases which can successfully enter the equation of reasonability and rationality: *historical cost, current cost, effectible value and updated value.*

1.***The historical cost*** is the evaluated origin cost, measured and registered at the entrance of actives and creation of debts. Regarding the actives, the historical cost consists of the cash amount paid or to be paid when buying or producing, which makes possible the acquirement of an economic good. Regarding the debts, the historical cost represents the value of the equivalents obtained in exchange of liability or, in some circumstances (as for instance the profit tax rate), and the value which is expected to be paid cash or cash equivalents in order to put out the debts, in a normal environment of business. The definitive characteristics of the historical cost are the possibility of checking and the objectivity which arise from its certification by accounting documents. It is the consequence of applying some accounting principles widely used in occidental customs, respectively the monetary nominalism and prudence. Once established, the historical cost stays unchanged, as long as the good remains under the business possession. In order to rely on the information provided by manufacturers, the internal and external users must ensure that the information is accurate and it is based on facts. And precisely the use of historical cost, as a measuring basis, allows the manufacturers to provide, in the financial situations, objective and verifiable information.

The historical cost may be defined as that „ *sacrifice which was agreed in order to bring the good within the business at its entrance date"* (Ristea, Dumitru, 2003, pp. 61). Considering that any cost or accepted sacrifice is, under the conditions of admitting into the role of the alternative costs, an undeveloped chance, as in order to ensure its functioning, the business must give up (its resources not being available for alternative usages) we may conclude: ***the historical cost used in measuring the real value may be defined in terms of agreed sacrifices (comitted costs) plus the cost associated to undeveloped chances (lost incomes).***Under these circumstances, we support ***the possibility of establishing a connexion to the opportunity cost*** (alternative cost or resignation cost), any option determining the resignation of another solution taken into account. The opportunity cost[1], as a conceptual similarity, is met again in researching the decisional situations and to the statistician Savage L.J who formulated the rule of minimization the regrets recommended for adopting the decisions under incertitude conditions. According to Savage analysis, the decisional factor must be permanently concerned about the regret minimization of not choosing the optimal decisional alternative (after making a decision, the decisional fact may ascertain that another decision would be better).

[1] The opportunity cost represents the cost of adopting of a decision expressed in terms of loss of benefices as a consequence of resignation of the most valuable next decision.

As it reproduces information about the value of balance sheet structures on the date of their acquirement, the historical cost orientates the business accountancy towards the past. The accounting professionals agree that the accountancy objective must not limit to reproducing the financial position and past performances of the business. For the investors, its perspectives represent a special importance. We join the opinion according to which, ***the historical cost becomes out-of-date comparing to the requirements of the users of financial situations whose needs of information reflect the evolutions of the global economic environment (these aiming the spectacular development of international financial markets, emerging and using at a large scale of some complex financial instruments, significant increase of financial risks, and so on).*** By using the historical cost, many of these instruments (and their afferent risks) are not reflected in the balance sheet and profit and loss account, which leads to the distortion of company image in front of his investors and creditors.

For these reasons, in time, a series of controvert's[2] of traditional accountancies appeared, who take into consideration well-established principles (prudence, historical cost, and so on), fact which determined that, after many decades of criticizing the reference accounting models, the anglo-saxon regulators to succeed in convincing the European Union to start a re-analysis of these fundamental principles, considered, this time, incapable of ensuring an enough representative evaluation of an business situation. In this respect significant, but also long talked about, is the enactment, in 2003, and putting into effect starting with 2005, of a set of measures, by the Commission for European Accounting Regulations, with reference to the replacement, in many situations, of the historical cost principle, used for the evaluation of actives and passives, with a new concept, and namely that with reference to ***fair value.*** This decision emphasizes the new orientation, IASB itself defining the fair value as being *„the quantum for which an active may be willingly changed between well informed parties within a transaction with the price objectively determined”.*

The controversy between the two evaluation models (historical cost and fair value) didn't have as a starting point the relevance of the information based on market prices but the period of time (the moment) to which belong the prices used in accounting evaluation. The difference between the two evaluation methods consists of the fact that, while the historical cost uses the market prices from the moment of achieving the actives or contracting the debts, the fair value resorts to the current ones. The fair value is based, in the first place, on the existent prices on the market as they reflect the market evaluation regarding:

- the updated value of the future flows of treasury incorporate in an element (calculated by means of the current flows of the interest);
- the risk that the amount or opportunity of these flows to be different from the expectations.

This leads to increasing the objectivity having as an effect the improvement of the informative value of the financial situations drawn up by the business. Thus we may

[2] “*The modern balance is a lie! It omitts the most important actives!”*. With these provocative words P.Kotler *(“Les cles du marketing*”, Village Mondial, 2003) declares against using the smallest price in accounts of non-material actives from the businesss accountancy. He considers as being a phantasmagoria the determination of a brand value, taking into account Coca Cola, a company which records sales of over 70 billions of dollars, only in terms of actives, considering of being important the value of its personnel, its partnership networks in the entire world and so on.

assert that, in a practical outline, the fair value materializes in the market value or in values derived from it.

The accountancy dictionaries define the fair value as a rational and correct estimation of the market price of a good, or financial active, by taking into consideration some elements such as: production/distribution costs, utility (regarding the goods and services), performance (for actives) or market disponibility.

But the notion of fair value is of American origin and its admission is explained by the fact that the financial instruments at term appeared in the United States of America having a spectacular development. The first references about the notion of fair value dates in 1984, when SFAS 80 is issued *Accounting for futures contract”*[3]. But the standard that consecrates the evaluation at a fair value, as a new accounting convention of evaluation of most financial instruments is FAS 133 *„Accounting for Derivate Instruments and Hedging Activities”*[4] published in 1998. By introducing the concept of fair value it was aimed the substitution of the shortcomings of the historical cost on the account of amendment the *„acquisition costs of actives with their market value (...) thing accomplished by permanent reevaluation of balance elements”* (Ionaşcu, 2003, pp. 107).

In the financial field there are two trends of opinion regarding the relation between the market value and the fair value:

- *efficient markets theory,* according to which on a well organized and informed market, the market price is equal or almost equal to the fair value, the investors having an immediate and adequate reaction to any external information;
- *behavioral theory,* according to which, on the contrary, the market price is the most of the times very different from the fair value as consequence of the collective spirit and emotional status of the investors.

In the past years, recognized for their orientation towards the stock market (whose values must also be expressed by accountancy), the most important normalization bodies (FASB, IASB) promote intensively the evaluation basis, called the fair value. The IAS 39 regulation, which regulated the evaluation of the financial actives, including the derivative instruments which constitute the actives, at their fair value, without any deduction of the dealing costs which may arise from sale or other assignation, is intensively criticized by the financial community[5], especially that IASB intends to expand the application framework of the concept *„full fair value”*[6]

We consider interesting the parallel definition of the fair value notion in the main conceptual frameworks: anglo-saxon, French and Romanian: (table 1).

[3] „Accounting the futures contracts”
[4] „Accounting of derivative instruments and covering activities”
[5] According to this regulation, whose application has been denied of one of the European states, a part of actives is accounted to their fair value and the other to the historical cost. For instance, the actives obtained at the end of transactions, the actives hold for sale (placement titles, portofolio activities titles) and their derivative products are evaluated to the fair value (in spite of the fact that, presently, the derivative products do not reflect the balance of some european businesss, although they form a in a considerable and undoubtful quantum). In exchange, the loans and the book debts, the financial passives shall be evaluated to the paid off cost.
[6] Fair value generalized for all balance posts.

Table 1

Definition of the fair value notion in the main conceptual frameworks

Conceptual framework	*IASB*	*FASB*	*French*	*Romanian*
Fair value	Represents the amount to which an active can be dealt or discounted a debt, willingly, between parties, learnedly, within the framework of a transaction where the price is objectively determined	Represents the amount to which an active can be bought or sold in a current transaction (other than the liquidation one) which takes place between parties, according to their will and the amount to which that debt is established within a current transaction (other than a liquidation), between the parties acting willingly	Does not designate a fair value or more fair than another, including the idea of pertinence (fact for which the term *„fair value"* from English has not been translated into French by *„ valeur juste",* but through the collocation *„juste valeur")*	Represents the amount to which an active can be dealt or discounted a debt, willingly, between parties, learnedly, within the framework of a transaction where the price is objectively determined

By means of the following table we shall reproduce, using the comparison method, a schematic presentation of the qualities of the fair value, compared to the limits of the historical cost.

Table 2

Comparative characteristics of the fair value and historical cost

Fair value	*Historical cost*
*offers information about the benefits expected of the actives or about the difficulties encountered as a consequence of the assumed debts, under the actual economic conditions; this thing *increases its utility*	*offers information about the benefits expected of the actives or about the difficulties encountered as a consequence of the assumed debts, according to the existent economic situation on the acquisition date or their contracting; *the utility is lower*
*reflects the effects of the management decisi-ons to keep the actives /debts or to take charge of anothers, as well as upon the performances and financial position of the business	*reflects the effects of the acquisition decisions of the actives or of debts contracting, but *ignores those of the decisions of keeping or their unjustified expense account*
*informs about the earnings and losses arisen as a consequence of the changes of prices, when they happen	*informs about the earnings and losses arisen as a consequence of the changes of prices, when they happen, through sale or discount, *even though these are not the events which have caused them*
*ensure the coherence of the active control of financial risks; the use of fair value for the evaluation of some financial instruments allows the reflection of their afferent risks, by presenting the pottential earnings and losses	**the bad management of the financial risks and the arisen of significant losses*
*frames the economic reality reproducing the probable value of liquidation of an business	*leads to a *„fictional accounting"*

Willing to be objective towards the supporters and controvertists of replacing the traditional basis of evaluation – historical cost – with the fair value we shall try to emphasize the main strong and weak points of the fair value, thus:

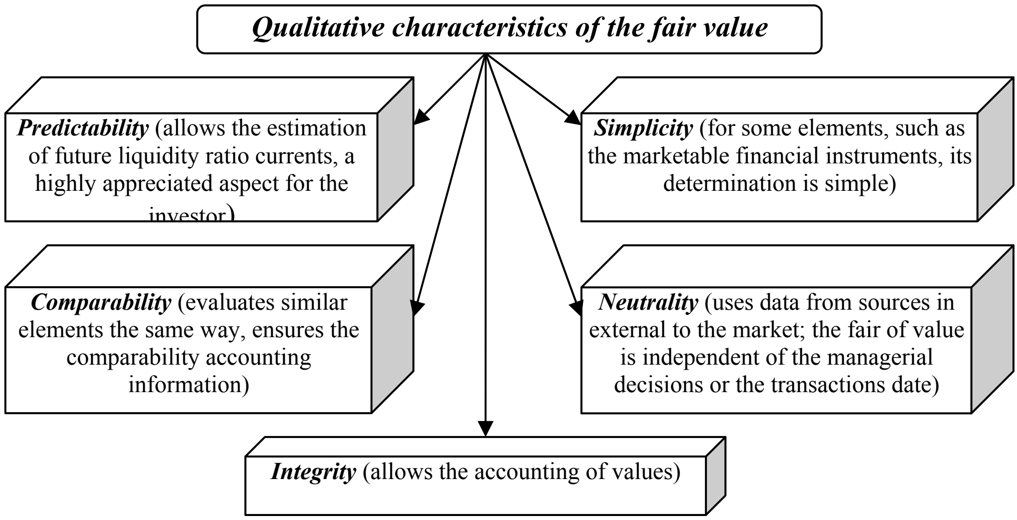

Fig. 1: Qualitative characteristics of the fair value

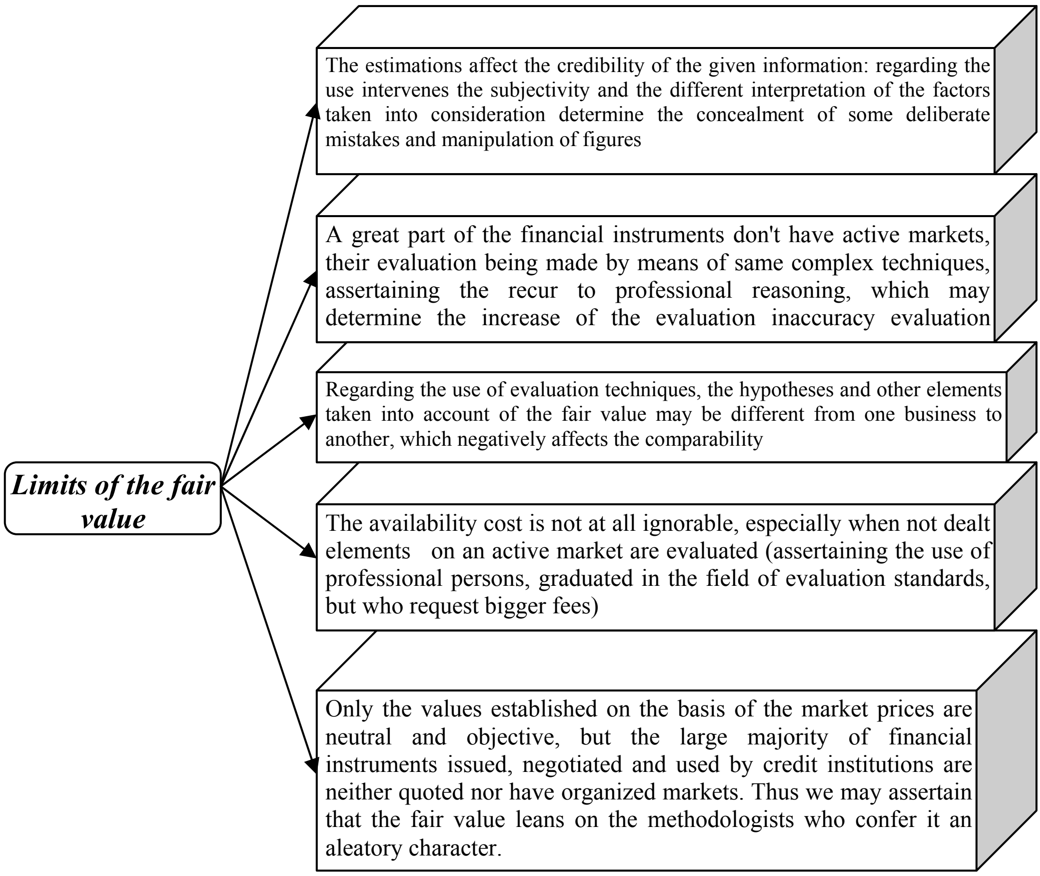

Fig. 2: Limits of the fair value

The method of comparison the qualitative characteristics and the limits of the fair value allows us to come to the conclusion that, ***although imperfect, the fair value approaches more to perfection than to the historical cost and while the historical cost***

is oriented towards the past, the fair value is oriented towards the future[7]***.*** Eventhough there must be noticed the fact that, for a long time, the replacement assayings of the historical cost as an evaluation bases have been doomed. Accounting professionals, lawyers of the historical cost, fermly sustained the necessity of the maintenance of the historical cost as a traditional basis of evaluation. They argue that, in case of actives/ debts which the business does not currently transaction, the use of the fair value does not offer useful information regarding the financial position and its performances, because it reflects the effects of certain transactions and the events the company did not attend to. Therewith, it affirms, that the accomplishment principle and the notion of transaction, in the actual acceptance, they are replaced through the continuous record of the variation of actives and debts value according to markets' evolution. As an answer, the supporters of the fair value consider that in actual the economic field, extremely dynamic, the significant changes which occur very fast may affect the intention or the ability of a business to keep an active/debt leading to the element's sale. In this case, it is used the fair value and not taking into consideration certain such modifications can influence in a negative way the performances of the enterprose misleading the users of the financial situations.

The supporters of the idea of imposing the fair value as a basis for evaluation emphasize the fact that, in the fair value model, the concept of results account must be thought again completely. Extensive application of the fair value to the assembly of actives and passives from the balance present two major correlated consequences: the resignation of the accomplishment criterion[8] and the loss of the transactions fundament from the results account. On the basis of the evaluation at the fair value is the principle according to which an active is cessioned, and a passive is permanently adjusted, finding actually the existence of a continuous virtual result[9]. Under these conditions there is not necessary the accounting validation of a cost considered current, because the market offers the possibility of following the corse of exchanged actives on the markets. We appreciate that, ***under the conditions of using the fair value model, the role of the results account should be limited at: reflecting the net oscillations (positive or negative) of the fair value of the instruments, over the period between the opening and closing the exercise, reflecting the general expenses, reflecting the expenses regarding the accession of the provisions etc.*** In this context, a new concept came into being, which stresses, through a single document[10], a new state of the business, meaning the *performance state* concept, protecting the necessity of changing the hierarchy of different financial situations. Thereby we identify a ***tendency to reduce (total or partial) of the interest for the results account and also to increase the interest regarding the performance situation, the balance maintaining its signification, and the situation of the flows of treasury becoming the main interesting document.***

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[7] Besides the accounting which uses the fair value remotes from the historical perspective, but gets closer to the current perspective of the value.

[8] The disappearance of the accomplishment criterion determines the abandonment of the historical account principle and the caution principle, in the measure in which the latent earnings are considered.

[9] Its arisen is determined by the inexistence of a real transaction, the market offering an information regarding to what it could have taken place.

[10] He shall refer to all the elements which have the result's nature, no matter if they are accomplished or latent, elements which are recorded in the results account, or directly into the own capitals.

We consider that the improbability of using the fair value as sole evaluation basis is owed to the strong opposition came from the side of the representatives of certain financial institutions (banks, insurance companies) which stress the negative consequences which they impress upon the business's handling through its application (respectively the increase of volatility, complexity and subjectivity of the accounting informations) that way leading to refuse of the fair value acceptation as a handling and financial raportation instrument.

At the present time, the use of a mixt evaluation model, through the combination of the two evaluation basis seems to be the only solution. The accounting professionals consider that the financial situations consolidated can be elaborated through the use to a larger extent of the fair value. The financial situations must offer, especially to the investors, useful information and for the individual accounts the historical cost shall remain the major evaluation basis for financial reasons but also for practical reasons.

Still we appreciate that, for a long term, ***the passing from the fair value is an evident tendency encouraged by the pressures of the accounting normalisation bodies which intensely promote it through the standards they elaborate.***

2.***The current cost (or the replacement one)*** represent the cost accepted by the business in order to ensure the attainment, at the current value level represents the cost accepted by the business in order to ensure the attainment, at the current value level, of a good similar to the one confined as the object of the evaluation. The current cost of the actives is represented by the cash value or cash equivalents which should be paid if the same active or a similar one would be acquired or manufactured at present. Regarding the debts it must be mentioned the fact that these are evaluated to the not-updated value of the cash or cash equivalents which is necessary in order to presently discount the obligation.

3.***The realisable value*** is represented by the *„value which the business would receive if it normally sold today the active or paid the debts"* (Ristea şi colaboratorii, 2004, pp. 344). For the actives the realisable value is equal to the cash value or cash equivalents, which can be presently obtained by their normal sale. It can be equal to the realisable gross value, with the net value (the sale value minus the sale costs), with the assignation (cession) value made under normal conditions or with the liquidation value. For the goods for which the use is continued, it is a minimal value, which is determined starting from the price market adjusted according as the place where the good is and its rate of wear. Regarding the debts, the realisable value is given by the not-updated value in cash or cash equivalents which must be paid in order to fulfill de obligations according to the normal run of the business.

4.***The updated value*** consists in the estimation, at present time, of the value, according as the future flows of benefices which manifest in the normal development of the activity (bringing up to date of a value which shall become available in future or in other words, the current value is determined by means of future).

The general accounting framework of IASB determines that:

- for *actives*, the updated value is the equivalent of the future flows of cash in-going which is expected to be generated by the respective good in the normal development of the activity;
- for *passives*, the updated value is the equivalent of future gross flows of cash (in-going) which are expected to be necessary in order to pay off the obligations which arise during the normal development of the activity.

Besides the evaluation bases previously presented we also identify a series of other values (Ristea, Dumitru, 2003, pp. 61):

- *registration or accounting value* is the value of which an active is included into the financial situations, then it is carried on the decrease of the accumulated damping and the accumulated losses of the devaluation;
- *the reevaluated value of an active* which represents the real value of an active at the date of the reevaluation except the subsequent accumulated devaluation;
- *the adjusted value* is the diminished value of the actives which depreciated; if the business intends to use the active in the manufacturing process, the adjustment for the diminution of the actives value is determined by comparing the recoverable value with the accounting value, apprehending the first; if the business does not intent to use the active in the manufacturing process, the adjustment for the diminution of the actives value is calculated by comparing the net realisable value with the accounting value, apprehending the first

as well as [11]:

- *the utilization value* is the updated value of the future flows of cash which expect to be generated by the continuous use of an active and its assignation at the end of the expendable life time;
- *the investment or subjective value* represents the value of a property for which a certain investor/investors category or for identified objectives of investments;
- *the recoverable value* (net realisable value) represents the estimative sale price which could be obtained during the normal development of the activity;
- *the liquidation value or the induced sale value* represent the amount which could be received, in a reasonable manner, from the sale of a property, in a too short period of time, the buyers being aware of the disadvantage of the seller;
- *the special value* is a supplement of value which can be applicable to a certain owner or user, or to a potential buyer or user of the property who has a series of special interests *(the value from the fusion)*, meaning the supplemental value resulted from the merger of two or more partnerships at the property represents a particular form of the special value);
- *the indemnification value of the loan on mortgage* represents the value of the property which is determined taking into account a cautious estimation of the future marketability of the property, taking into account the maintainable aspects on long term of the property, the normal and local market conditions, the current use and adequate alternatives of the property (it is a component of the technique of risk analysis on long term and not a basis for establishing the value at a certain moment and, as a consequence, differ essentially from other evaluation bases).

Also, in speciality literature, we retrieve the notion of *business value (dispossession value)* representing:

- the price which an authorized and cautious business leader would consent to pay in order to acquire the good;
- the maximal loss (deprivation or penury cost) which the business would accept today, if it didn't have the mentioned good.

This value shall always depend on the circumstances in which the business is found. On one hand, if the business places the active on a profitable utilization, its value within the most profitable utilization (the recoverable value) shall be bigger than the

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[11] International Standard of Evaluation 2 (IVS 2).

replacement cost and thus the situation when the entity shall be dispossessed of the active, it shall proceed to its replacement, the value for the business being represented by its replacement cost. On the other hand, an active shall not be replaced if the cost of its replacement is bigger than its recoverable value, in this situation the value for the business being represented especially by this recoverable value (the reasoning must be searched in the fact that the lack of good would drive a smaller loss than the replacement cost; even if the business hold the necessary amount for the replacement, it would better use these funds by not replacing the good, as the replacement cost would be bigger than what it could obtain from the sale or utilization of the good. Thus, is can noticed:

- when the most profitable utilization of an active is its sale, its recoverable value shall be the amount which can be obtained from the sale, from which the expenses were deduced with the sale (the recoverable value being the net realisable value) ;
- when the most profitable utilization of an active is its continuous use, its recoverable value shall be represented by the presented value of the future flows of treasury obtained as a result of the continuous use of the active and as its last sale, from which it was subtracted any expence which might suppose its lead out (the recoverable value being the utility value).

We conclude by emphasizing the fact that choosing the evaluation bases and the maintaining concept of stock level determines the used accounting model for the elaboration of the financial situations. There are different accounting models which present a certain level of relevance and credibility, and the manager has the role of establishing their equilibrium.

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