

STANDARDISATION AND PROFESSIONAL JUDGMENT IN THE ACCOUNTING PRACTICE

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Abstract: *The paper approaches the socially regulated character of accounting practice through norms (standards) and judicial regulations, and the role of professional judgment within this context.*

Key words: *accounting, standards, normalisation, convergence, accounting policies, judgment, practice.*

The accounting practice, which was, at its beginning, seen as a skill based on the empirical knowledge of those who practiced it, became, at a certain moment during its evolution, a profession which is socially regulated by means of norms and standards.

As a social practice, accounting is, nowadays, regulated by means of norms (*standards*) and judicial statutes, being a 'normalised representation' of an entity on the grounds of more or less regulated conventions.

The concept of '*normalising accounting*' contains, besides the process of elaborating norms, defined by the concept of 'accounting regulation', which represents the 'nucleus of normalisation', and the conceptual aspects of accounting³⁹⁹, respectively the elaboration of a suitable framework for the proper application of these rules, with the aim of ensuring the comparability, in time and space, of the relevance and reliability of the accounting information.

The norms represent precise rules of evaluation, registering, classification or presentation of the accounting information. The French PCG defines the norm as 'reference data which results from a reasonable collective choice with the aim of solving repetitive problems.'

Accounting normalisation became, in the latter half of the 20st century, a reality and a direction in the development process of accounting and, after World War 2, national and international institutions were created with this purpose.

Accounting normalisation was firstly determined by pragmatic necessities, having as objectives⁴⁰⁰: *the regulation of accounting practices*, thus determining an amelioration in accounting; the increase of the efficacy of accounting information in decision-taking; the creation of an environment of mutual trust between the capital owners and the business managers; the granting of a certain extent of protection for the financial auditor by limiting his responsibilities (the auditor limits his responsibilities to a representation of reality in compliance with the acknowledged accounting norms and not to an faithful representation of the economic reality); it also functions as a referee among the different parts taking part in the economic life and particularly as a referee between the producers of the accounting information and the financial auditors who certify the quality of the information, therefore ensuring the social validation of the accounting information; it allows for the consolidation of the accounting information at the level of society-groups; it permits the elaboration of statistics.

Additionally to these pragmatic objectives we must also add the fact that accounting normalisation contributes to the development of the 'accounting theory', because the products of normalisation constitute themselves in real theoretical assemblies, like the 'generally accepted accounting principles', 'the national accounting plan', or the 'conceptual frame of accounting', which form the normative theory of accounting.

We can thus consider that the normalisation process stimulates and improves both the accounting practice and thinking, contributing to the perfecting of accounting, to the appearance and checking up of accounting

³⁹⁹ Pop Atanasiu, *Contabilitate comparată și aprofundată*, Editura Intelcredo, 1996, pp. 22-23.

⁴⁰⁰ Ion Ionașcu, *Epistemologia contabilității*, Editura Economică, București, 1997, p. 71, and Feleagă Nicolae, *Înblânzirea junglei contabilității*, Editura Economică, București, 1997, p. 179.

theories and hypotheses, representing the premise of the accounting research of a normative type/normative accounting research.

The first operational variant of the normative theory took the shape of *accounting principles* which were outlined in the former part of the 20th century, in the United States of America. The formulation of accounting principles by the American normative agent was initially elaborated starting from the observation of accounting practices or from their application, and, because of that, they reflected, as Colasse considers, a ‘theorised practice’⁴⁰¹, a normative-inductive accounting theory. As these principles had a descriptive character, they represented theoretical directions related to the manner in which the accounting information should be elaborated and presented by various companies. Due to the fact that accounting principles could not ensure a theoretical basis for the elaboration of coherent accounting norms, subsequently, after 1970, the American accounting profession drew up a normative-deductive accounting theory, under the form of the ‘*conceptual accounting framework*’, destined to serve as a conceptual basis for the formulation of accounting norms, or, in other words, to ensure ‘the theoretical foundation of firm accounting’.

The American accounting conceptual framework contains: the objectives of financial statements, the qualitative characteristics of the financial and accounting information, or the accounting principles and concepts employed for the preparation of financial statements.

As it is known, the American accounting conceptual framework has had an important influence on the national or even international accounting doctrines. It has also represented a source of inspiration for the conceptual frameworks drawn up by many countries, and even for the *Framework for the Preparation and Presentation of Financial Statements* drafted by the international accounting standard-setter namely IASC (International Accounting Standards Committee), renamed as IASB (International Accounting Standards Board) after its reformation in 2001.

In the majority of continental European countries (France, Germany, the Soviet Union, Spain, Italy, including Romania), the normative accounting theory manifested under the form of the ‘*national accounting plan*’ consisting of: the accounts system (the designation, classification, codification and the functioning rules of accounts); the organisation of accounting documents and registration, validation, and operation-control procedures. Such a type of normalisation does not define the objectives of financial statements and the qualitative characteristics of the accounting information.

The problem of accounting normalisation, after the 60s, went beyond the national borders. The International Accounting Congress which took place in New York, in 1962, developed as a major study theme *the professional accounting principles and practices* which could be taken into consideration for the prospect of an international normalisation⁴⁰².

International normalisation involves the elaboration of norms and rules which could be applicable – entirely or partially – in some states or at the level of similar enterprises from different states. As an effect of this phenomenon, the financial statements of the enterprises will contain financial information which is more reliable, more transparent and comparable, and this is necessary for the efficient running of stock exchanges, banks and foreign investors.

Accounting normalisation, which takes place on the grounds of a necessity for universality in accounting, also enforces its complement, namely *international harmonisation* (the harmonisation between national, regional and international). This does not imply that there is a unification of accounting at an international level, but it entails universality in the accounting doctrine, not in the accounting procedure as a system of correlating signs, which is exercised within a previously codified conventional framework that cannot be available everywhere, and at the same time.

By means of the harmonisation process, which is a flexible and an open process, the national accounting norms and practices, often differing or even contradictory from a country to another, undergo certain improvements so as to reduce the major differences, aiming at facilitating the comparability of the financial statements which are elaborated and published by companies from different countries.

Pursuing the elaboration of an *international accounting doctrine*, respectively the formulation of some fundamental conventions to which any drafting, interpretation or application of the accounting and financial reporting norms would make reference, in 1989, IASC approved and published the ‘*Framework*

⁴⁰¹ Ion Ionaşcu, *Dinamica doctrinelor contabilităţii contemporane*, Editura Economică, Bucureşti, 2003, p. 22.

⁴⁰² André Cibert, *Comptabilité générale*, septième édition, Paris, 1986, p. 84.

for the preparation and presentation of financial statements' – a specific case of normative accounting theory.

This Framework assists the IASC/ IASB team in the elaboration of future standards and in revising the existing ones, as well as in the promotion of harmonising accounting regulations, standards and procedures related to the presentation of financial statements by advancing a basis to reduce the number of alternative accounting treatments allowed by IAS/IFRS. Additionally, the Framework helps the national authorities in the development process of national standards, it also enables the assisting preparers of financial reports to interpret the standards and to tackle the aspects constituting the subject of IAS/ IFRS, it assists the auditors to express opinions regarding the conformity of the financial statements to IAS/ IFRS, and it helps the users of financial statements to interpret the information in the financial statements elaborated in compliance with IAS/ IFRS.

The international organisation IASC/ IASB cooperates closely with national accounting standard-setters, among which a privileged position is held by the American body for accounting normalisation, namely the Financial Accounting Standards Board – FASB. In fact, it is considered that⁴⁰³ the international accounting environment draws on two recognized international referential boards: IASB and FASB.

A common process is the convergence between the international referential accounting system and the American one. Besides the Norwalk agreement in September 2002, in which the two organisations concurred on a calendar and on a method regarding the convergence process, IASB and FASB also signed an agreement to establish *a new conceptual accounting framework*.

We must also specify the fact that the representative normalising agents in the entire world work on this new image of the 'accounting constitution', specifically a *single conceptual framework* (a common conceptual framework) a reference document for the elaboration of international standards of financial reporting *based on principles*.

Numerous voices demanding the elaboration of principle-based standards instead of those grounded on rules are becoming more and more visible. In addition, such an alteration in the logic of normalisation is pushed forward by the new American regulation represented by the Sarbanes-Oxley law from 2002, a law enforced after the bankruptcy of Enron and WorldCom. Thus, in July 2003, SEC published a report in which it recommends that the 'normalising agents should be heading more systematically towards the elaboration of principle-based standards'.

It is known that the two important accounting systems internationally recognized comprise distinct normalising reasoning⁴⁰⁴:

- in the case of Europe (and implicitly in the case of IFRS, adopted by the majority of countries, including Great Britain) there is a certain number of **principles** to be complied with; in accordance to these, auditors can invite an enterprise to correct the accounting evaluation;
- in the case of the USA, there is a comprehensive list of **rules**; the 'generally accepted accounting principles', the US GAAP, form a volume of approximately 140,000 pages which answers the majority of interpretation problems, but an imaginative accountant will still find the possibility to invent 'stylisations'.

In order to achieve the convergence, IASB struggled for the implementation of the best accounting practices at the international level.

The shift towards the application of the International Financial Reporting Standards (IFRS) which allow for the existence of numerous options to accounting treatment for a certain element or event, is a challenge for the professional reasoning, the accounting policies and the 'methods becoming increasingly proficient and difficult'⁴⁰⁵.

The implementation of International Financial Reporting Standards by means of resorting to professional judgment, offers the accounting professional increased abilities and powers, being, at the same time, an additional element of responsibility.

⁴⁰³ Niculae Feleagă, Liliana Malciu, Ștefan Bunea, *Bazele contabilității - o abordare europeană și internațională*, Editura Economică, București, 2002, p. 31.

⁴⁰⁴ Feleagă (Malciu) Liliana, Feleagă Niculae, *Contabilitate financiară – o abordare europeană și internațională*, vol. I, Editura Infomega, București, 2005, p. 256.

⁴⁰⁵ Ristea Mihai, *Opțiuni și metode contabile de întreprindere*, Editor Tribuna Economică, București, 2001, p. 9.

Experts maintain that a national deregulated normalisation of accounting should be imposed, in which 'professional reasoning and its complement, *materiality*, enforce the rule in the selection of accounting policies and treatments'⁴⁰⁶.

Professional reasoning is carried out when we formulate the *accounting policies*. From among the spheres in which the estimates and the judgment of managers, or of accounting professionals play a significant role we mention the following⁴⁰⁷:

- the recognition of certain elements in the balance sheet (assets or liabilities) or in the revenue and expense accounts (income or expenses);
- the determination and taking into consideration of the signification point in order to establish the presentation manner in the financial statements of certain elements (assets or debts) in distinct classes if they are significant, or globally, in a general (common) category, if they are insignificant;
- the choice of the methods for assessing in the balance sheet for the various reported elements, respectively:
 - the option for: basic treatment or accepted alternative treatment and, in the latter case, the option for fair value or present value;
 - the option for stock assessment methods: CMP, FIFO, etc..
- in the case of tangible and intangible assets which can be amortised:
 - the determination (estimation) of the useful life of an asset to be depreciated;
 - the determination (estimation) of residual value;
 - the determination of the depreciation method;
 - the periodical revision of the useful life, of the residual value and of the depreciation method.
- in the case of financial investments: classifying financial investments in 'current' or 'non-current' ones, depending on the estimates referring to the time span in which these investments are kept;
- making adjustments for assets;
- the determination of provisions and contingent liabilities;
- etc..

Synthesizing, professional reasoning is exercised either on the occasion of current assessment, initial recognition of the elements in financial statements or their derecognition, or on the occasion of assessment for the presentation of information in financial statements, when:

- we opt for one of the allowed treatments (the capitalization of expenses or the recognition in the revenue and expense account);
- we opt for one of the permitted evaluation methods for assets;
- we opt for a particular depreciation method;
- we perform accounting estimates.

The Romanian national regulations concerning accounting also assume the concept of accounting policies stated in IFRS. These are defined as representing the specific 'principles, foundations, conventions, rules and practices adopted by an entity in developing and presenting financial statements'.

Accounting policies related to the drawing up and presentation of financial statements are based on the requirements in the IFRS standards and the IFRIC interpretations. When there are no specific requirements (in other words, when there is no standard or interpretation which applies particularly to an event or to a transaction), the enterprise management, by means of the experts in the field, will make use of **its**

⁴⁰⁶ Ristea, Mihai, *Normalizarea contabilității – bază și alternativ*, Editura Tribuna Economică, București, 2002, p. 9.

⁴⁰⁷ See Ministerul Finanțelor Publice – *Ghid practic de aplicare a Standardelor Internaționale de Contabilitate* – Partea a I-a, Ed. Economică, 2001.

professional judgment⁴⁰⁸ so as to draw up and apply an accounting policy which leads to information that is relevant to the users' necessities in taking economical and credible decisions.

Therefore, each company must establish accounting policies for the activities performed. The accounting policies must be prepared, taking into account the particular nature of the activity, by the experts working in the economic and technical domain, who are *specialists in the performed activity and in the company's strategy, respecting the general accounting principles stated in the regulations*.

Along the ages, the idea that 'a good manager is the one who has a good accountant' has been widely spread. We consider that the syntagm is even more valid under the conditions of applying the IFRS, but not understood as appreciating the accountant's skill due to his efforts to minimize the 'fiscal basis (the fiscality) of the business', but owing to the accountant's ability to understand the real situation of the firm, and to obtain, by professional reasoning, financial statements with relevant, plausible and useful information for the wide range of users.

For the information presented in the financial statements to be reliable, it must answer, among others, the condition of completeness. But, for its accomplishment, the applied accounting treatment must be presented in the notes to the financial statements in their entirety.

Accounting normalisation is able, by issuing norms (standards), to restrict the accounting options for the same category, or to limit the role of professional judgment.

Despite all the normalisation efforts, there will always be a certain advance of accounting practices over accounting norms. Reality is much more complex than the provisions of a regulation, and when there is some insufficiency or even a deficiency in norms, the conveyance of an accounting solution would be possible only on the basis of professional judgment. Such a solution would be controversial, involving a high degree of subjectivity considering the experience of that professional. This is why an enhancement of *accounting conceptualisation* is necessary, the starting point being represented by the concept or, more generally, by the *accounting theory* and not by the norm, an accounting theory which comprises sufficient hypotheses that correspond to the reality. A proficient accounting theory would enable the reflection of reality with a 'reasonable amount' of subjectivity⁴⁰⁹ if there is no norm or if it is insufficient.

Starting from the limits of accounting principles/conventions, the producers of accounting information resort to different methods so as to 'mould' – even up to 'deformation' – the financial position and the performance, the practices employed being formalized, in an elegant manner, under the designation of 'accounting policies', or 'result-adjustment policies'.⁴¹⁰

The application of professional judgment, which takes advantage of the existing gaps in the norms and of their flexibility, allows for the manipulation of accounting figures and for the transformation of financial statements from what they should be into what their makers want them to be.

Such a method of exercising professional judgment could lead to the example of 'creative accounting' techniques. Due to them, accounting experts use their knowledge with the aim of manipulating the values of the information reported in the financial statements. These techniques could be directed in the following ways:

- increasing or diminishing the value of income;
- decreasing or increasing the value of expenses;
- increasing or decreasing the value of assets;
- decreasing or increasing the value of liabilities;
- inaccurately classifying the assets or the liabilities;
- avoiding the presentation of significant information in the explanatory notes;

These have as final effects the variation of the income and the variation of the equity and, consequently, the alteration of the indicators' dimensions of profitability, liquidity, financial independence and indebtedness, or, in other words, they 'beautify' the financial position and the performance of the enterprise.

⁴⁰⁸ IAS 8 „Accounting policies, changes in accounting estimates and errors”, paragraphs 7-12.

⁴⁰⁹ Ionașcu Ion, *Dinamica doctrinelor contabilității contemporane*, Editura Economică, București, 2003, p.170.

⁴¹⁰ Ristea Mihai, *Opțiuni și metode contabile de întreprindere*, Editor Tribuna Economică, București, 2001, p. 226.

Even though accounting is a universal necessity, it still remains a local practice. According to some authors⁴¹¹, the internationalisation of financial flows will not lead to the 'transformation of accounting in a uniform worldwide practice, under all its aspects', but it will only lead to the harmonisation of financial reporting, because the local context will retain its specificity, namely: the existence of more business cultures, different levels of economic development, diverse tax systems, or the dissimilar relation of accounting to the legal system and to fiscality etc.

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⁴¹¹ Ionașcu Ion, *Dinamica doctrinelor contabilității contemporane*, Editura Economică, București, 2003, p.59.