POSSIBILITIES OF IMPROVING INFORMATIONAL QUALITY REGARDING THE FINANCIAL POSITION

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Starting from the analysis of the Romanian accounting regulations applicable to the economic operators, as well as from the findings of a study we have done regarding the financial statements of certain commercial societies quoted on the Bucharest Stock Exchange, in this article we signal some aspects which, in our opinion, require some clarifications and which could have as an effect the improvement of informational quality related to the financial position presented in the balance sheet.

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M: Business Administration and Business Economics; Marketing; Accounting

It is considered that the balance sheet in a vertical format allows providing information about the ***financial position***, showing the relationship between assets, liabilities, and equity. The financial position of an enterprise is affected by[554]: the economic resources it controls; its financial structure; its liquidity and its solvency; its capacity to adapt to the changes within the environment where it performs its activity.
The equation by means of which it is calculated the synthetic information about the financial position, and which is specific to the vertical balance sheet is:

$$\boxed{\text{Total assets} - \text{Total liabilities} = \text{Equity}}$$

But in the current format of the balance sheet drawn by the Romanian enterprises, namely in the vertical balance sheet, it is not calculated a total of the assets and a total of the liabilities. On the contrary, there is a gradual calculation of the *equity*, finding out intermediary indicators, and these are: (1) *Net current assets*/ *Net current liabilities*; (2) *Total assets minus current liabilities*. These two intermediary indicators are meant to indicate in fact the *Working capital* and the *Permanent capitals*, indicators of the financial balance, and, for their calculation, within the financial analysis, the "financial balance sheet"[555] is used.

In order to calculate these intermediary indicators it is necessary to separate the debts and liabilities depending on the liquidity and exigibility, having in view the time limit of a year. In the case of liabilities this calculation is totally solved by means of the current structure of the accounting balance sheet. The Romanian Accounting Regulator provisioned the following two structures in the balance sheet[556]:

- D. Liabilities: amounts becoming due and payable within one year;
- G. Liabilities: amounts becoming due and payable after more than one year

554 See the Framework for the Preparation and Presentation of Financial Statements of IASC/ IASB, paragraph 16.
555 The accounting balance sheet in a vertical format resembles the financial balance sheet, but they are not identical because the two balance sheets are based on different perspectives: the accounting balance sheet is based on the continuity of the activity (going concern) whereas the financial one is based on the perspective of ceasing the activity.
556 Both of them include the same classification of liabilities according to their character: loans from the issuing of bonds, separately presenting the loans from the issuing of convertible bonds; sums owed to the crediting institutions; advance money cashed in the accounts due to orders; commercial liabilities – suppliers; payable combination; sums owed to the affiliated entities; sums owed to the entities the company is connected to by virtue of participation interests; other liabilities, including fiscal ones and the liabilities regarding social insurance.

On the other hand, in the case of debts the problem of presentation in the balance sheet is only partially solved depending on the time-limit for the cashing in. It is only for a part of the debts classified at the initial recognition as non-current assets (long term receivables) – namely for those considered as having a commercial character[557] – that the presentation at distinct positions in the balance sheet is provisioned depending on the time-limit when they are due to be cashed in[558].

The organism of normalization, probably considering that these are only exceptions when the debts classified at the moment of initial recognition as current assets (registered in accounts of the 4th class) having more than a year as a settlement date, did not ask for their presentation as a distinct position in the balance sheet, but only includes an endorsement as follows: "*II. Debts* (Amounts becoming due and payable after more than one year must be shown separately for each item)". The endorsement is taken literally from the IVth European Directive. We understand then that such a presentation will have to be performed in the explanatory notes (obviously, the offering of such information in notes allows the users to adjust the information). If this is the situation, then we observe some inconsistency in the regulator's reasoning. In the case of liabilities classified at initial recognition on a short term the presentation on distinct positions in the balance sheet is provisioned depending on the deadline for payment. But as long as in the balance sheet of a customer the liability to the supplier is presented, for instance, as a "amounts becoming due and payable after more than one year", it is normal that the balance sheet of the supplier in discussion should contain a separate presentation if the debt to the customer, as a "amounts becoming due and payable after more than one year"[559].

Continuing our reasoning, if for the debts classified at initial recognition as being current assets there is the requirement that the sums to be cashed in after more than a year will be presented separately, we think that it is necessary for the deferred income and accrued expenses to be presented separately – information which is taken into account for the indicator *Net current assets/ Net current liabilities* – and these should be presented within 12 months.

It is known that the indicator *Net current assets/ Net current liabilities*, which we conventionally record as Ac_n/ Lc_n, are determined, in the balance sheet, by means of the equation:

$$\boxed{Ac_n / Lc_n = Ac + E_a - L_{<1\ year} - I_d}$$

in which:

Ac = total current assets[560];

E_a = Accrued expenses;

$L_{<1\ year}$ = Liabilities to be paid within one year

I_d = Deferred income.

Or, how does this indicator represent the "*net current assets*" if in the contents of the elements at the basis of its calculation (accrued expenses and deferred income, respectively) there are values which become due in a period which exceeds a year?

557 Receivables corresponding to the contracts of financial leasing and to other assimilated contracts, as well as other long term receivables.

558 The ones due to be paid in a period of less than 12 months are shown as Trade debtors, and the ones due to be paid in a period of time exceeding a 12 months, as financial immobilizations, at the position Other Loans.

559 It is clear that we could be tempted to say here "to be presented as immobilized assets" but, according to the national accounting regulations, "the presentation of assets as immobilized assets or as current assets depends on the purpose of their usage" (item 27), and not on the accomplishment or clearance date. We can see that, from this perspective, the Romanian regulatory agent considers the "debts corresponding to the contracts of financial leasing and to other assimilated contracts, as well as other immobilized debts" to be immobilizations only partially, or partial current assets.

560 Stocks + Debts + Short term investment + Cash and bank accounts.

Analyzing the annual financial statements of various entities it was revealed that there are cases when the debt corresponding to the deferred income (as an effect of invoicing) or the liability corresponding to the accrued expenses is recorded among the long term receivables, or liabilities which must be paid in a period exceeding 12 months[561], while the deferred income and accrued expenses are considered to be current assets or liabilities having a clearance date less than 12 months, and they are taken into consideration when calculating the indicator *Net current assets/ Net current liabilities*. It is obvious that, in such cases, this indicator is misrepresented. We believe that the deferred income and accrued expenses, which have more than 12 months as a falling due, should affect the intermediary indicators in the balance sheet which are established taking into account the immobilized assets or the liabilities to be paid in more than a year's time limit.

As for the indicator *Total assets minus current liabilities* ($TA - L_{< 1\ year}$), this is calculated by adding to the *Total immobilized assets* (A_i) the *Net current assets* (Ac_n) and by subtracting the value *Subsidies for investment* (Sv_{inv}). Thus,

$$\boxed{TA - L_{< 1\ year} = A_i + Ac_n{}^{562} - Sv_{inv}}$$

Observing such an equation, a question necessarily arises: what is the role of *subsidies for investment* in this equation in which, having in view the denomination of the indicator, we understand that the elements taken into account represent either current liabilities or assets?

Our opinion is that the *subsidies for investment* in this equation have the role of correcting the value of immobilized assets, and this is in fact the reason for which they were received. As a result, even if the Romanian accounting regulation establishes, as a reporting request, that the presentation in the balance sheet of the subsidies should be taken as deferred income, and not by deducting them from the value of assets so as to calculate its net value[563], yet it considers the subsidy as a diminution of the immobilized assets' values when the indicator *Total assets minus current liabilities* is calculated.

Note: As a result of the alterations of accounting regulations by means of the OMPF no. 2374/ 2008, when calculating the indicator *Total assets minus current liabilities* the subsidies for investment are no longer taken into account. As long as the Romanian regulator makes no remark on this aspect, we are inclined to believe that there might be an error in the elaboration of the structure of the balance sheet. Or it is possible that the Romanian regulator could have changed its perspective regarding the subsidies for investment and to consider them as elements of the equity. In this case it would have been better if the subsidies for investment had been taken into consideration when calculating the indicator *Equity – Total* and this fact did not happen. In addition, in the accounting regulations (item no. 197) it is clearly settled that "subsidies must not be directly registered in the capital accounts and reserves.

Starting from the indicator *Total assets minus current liabilities*, in order to calculate the *Equity*, we should diminish its value by subtracting the *Non-current liabilities* (the sums to be paid in a period of time exceeding a year).

Consequently, whether we want to reach the synthetic information regarding the financial position directly – as the difference between the *Total assets* and the *Total liabilities* (which requires the calculation of the value of these terms) – or gradually, by means of intermediary

561 See, for instance, the interests for the financial leasing which are registered complying with the leasing contract as revenues, and, respectively, as expenses.

562 So that our reasoning could be clearer, we considered that the indicator Net current assets/ Net current liabilities has positive values, representing, therefore, the Net current assets.

563 These represent actually the two methods of presenting the subsidies for investment in the balance sheet according to IAS 20 Accounting for government grants and disclosure of government assistance. As for the IVth Directive, this does not contain any mention concerning subsidies.

indicators, we find the *Provisions* which are presented separately in the structure of the balance sheet[564]. Are they considered to be *Liabilities* or *Equities*?
It is known that in the specialized literature some authors do not consider that the provisions for risk and expenses are liabilities, but they are seen as elements "assimilated by the equities", or as "owned resources with a special destination", whereas other authors see them as liabilities.
Nevertheless, the position of the Romanian regulator is clear and it considers the provisions as liabilities. This results both from the definition given to the provision which can be found in the Romanian accounting regulations[565] – a definition taken from IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* – and from the fact that, in the structure of the balance sheet, the indicator *Equity* is already calculated, without taking into consideration the *Provisions*, too.
And if the provisions are liabilities, then they should also be classified according to exigibility[566]: more than a year, or less than a year. If we consider that all the provisions are non-current liabilities, some of the indicators of solvency and liquidity could obviously be affected.
A distinct presentation of the two categories of provisions, having in view a 12 months' time limit, could enable the indicator *Total assets minus current liabilities*[567] to truly represent what is expected, namely the *Permanent capitals* (liabilities with a falling due which is longer than a year + equities)[568]. As a result, the indicator *Total assets minus current liabilities*, in its current form in the balance sheet, should also be diminished by subtracting that part of the provisions constituted for a period less than a year, enabling only the provisions constituted for more than a year to function as permanent capitals.
What is important is that the indicator *Total assets minus current liabilities* should correctly represent what is expected from it to represent (Permanent capitals), but, besides this, it is important because it intervenes in the calculation of other economic and financial indicators, such as, for instance, the *profitability of the employed capital* and the indicator *debt-to-equity ratio.*
As a conclusion to the problem discussed here, we consider that the accrued expenses, the deferred income and the provisions, just as the debts under the form of current assets, should be structured in two categories depending on to the term and presented in the balance sheet as such,

564 It is well-known that in the balance sheet, together with the actual structures of assets (immobilized assets and current assets), liabilities (two categories, depending on the exigibility) and equities, there can also be found other structures like: accrued expenses, deferred income (containing subsidies for investment and deferred income) and provisions. Regarding the accrued expenses and deferred income (and also regarding the subsidies for investment) we have expressed our opinion in the information above, when we discussed about the intermediary indicators. The problem of provisions still has to be clarified.
565 A "provision is a liability of uncertain timing or amount" (see Accounting regulations compliant with the IVth Directive of CEE, endorsed by OMPF no. 1752/ 2005, item 184, indent (1), and in IAS 37, Provisions, Contingent Liabilities and Contingent Assets, paragraph 10. The fact that the provision is a liability also results from the contents of art. 20, indent 2, of the IVth Directive, transposed into the Romanian accounting regulations (item 34): "Provisions are intended to cover liabilities the nature of which is clearly defined and which at the date of the balance sheet are either likely to be incurred, or certain to be incurred but uncertain as to amount or as to the date on which they will arise".
566 Such a separation of provisions depending on the due date is taken into consideration by the Romanian regulator in case of the public institutions. The provisions occur as a distinct position in the two types of balance sheets regarding liabilities: "current liabilities" and "non-current liabilities" (see Balance Sheet presented in Annex 13 for Methodological Norms Regarding the Organizing and the Management of Public Institutions' Accounting endorsed by OMPF no. 1917/ 2005).
567 Obviously, the presentation of provisions which have as a falling due less than a year as being current liabilities will also influence the value of the indicator previously presented by us, namely the Net current assets/ Net current liabilities.
568 The organism of normalization (regulatory) aimed that, by means of the indicator calculated in the balance sheet, it could present the Permanent capital, and this also results from the explanation of the terms in the equation used for the calculation of the indicator the profitability of the employed capital, in Note 9, specifically "the employed capital […] includes the equity and the non - current liabilities or total assets minus current liabilities".

in order to be able to take their value into appropriate consideration when calculating the indicators.
We consider that if the structure of the balance sheet will not be modified as shown above, it is important that such information should be offered at least in some notes, with details according to the term, in order that the users who want to draw comparisons to be accurately informed.

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