

# THE ACCOUNTANT PROFESSIONAL AS A CURRENT USER OF PROFESSIONAL JUDGMENT

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## Abstract

*Professional judgment governs the evolution of a process in the absence of any relevant procedural regulations. In this paper we will describe both the building components of the professional judgment and the accounting professional as a practitioner whom use most often the expression of the above mentioned type of judgment.*

**Keywords:** *professional judgment, practitioners, economics, decision making, financial statement.*

## 1. Introduction

Within a company, professionals are required to get involved in activities that do not always provide predictable trajectories. Their job's specifics impose the professionals to assume responsibilities stated in their job description as also responsibilities that are forming along the situations get more particular. At this point, the professionals assume the exertion of decisions starting from the idea that a package of information, of hypothesis and demonstrations can be preferred to a certain situation, not generalized instead of an absolute ideological package. In order to differentiate these two categories, the action of a rigorous formulated professional judgment is required.

Professionalism (professional consciousness) is complex, discretionary, requires practical and theoretical knowledge, qualification and also the acknowledgment that people without experience cannot understand, fully read and evaluate at a high level the results of the practiced labor.<sup>1</sup>

Professional practice, without a strong judgment to stand as foundation cannot be labeled more than a technical labor.<sup>2</sup>

Professionals use the professional judgment as a fundamental logical form comprising of a correlated stream of arguments<sup>3</sup>. According to prof. David Tripp, the professional judgment suits into 4 shapes:

- Practical (that type of judgment almost instantly formulated)
- Diagnostic (generalized judgment within the professional practice)
- Reflective (judgment of evaluation and justifying nature that emerges when the practitioner reflects in detail over its own actions and effects,

weighting all alternative strategies)

- Critical (judgment that cumulates both a critical and reflexive attitude and also the diagnostic process of the professional practices)

Prof. Della Fish and Prof. Colin Coles are proposing the following classification of professional judgment<sup>4</sup>:

- intuitive
  - emerges in the situations that require an immediate reaction and supposes the quick establishment of the working instruments and the required skills needed to resolve the issue that emerged. It does not involve a preexisting judgment, this type of understanding being labeled usually as technical of "instrumental"<sup>5</sup>.
- strategic
  - has an urgent character that supposes a wide spectrum of possibilities.<sup>6</sup> It is based on practices that are highlighted in well established procedures.
- reflective
  - seeks situations that emerge in practice along with a high level of uncertainty. This category implies a profound thinking in the solving process, a cumulus of personal thinking process, of own skills.
- deliberative
  - it is described by the moral character of decisions and focuses both the entity's interests and also the individual's.

Professionals see these practices in these circumstances as being moral concurrent ideas that can generate conflicts and dilemmas hard to solve<sup>7</sup>.

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<sup>1</sup> Freidson, Elliot. "Professionalism reborn: Theory, prophecy, and policy". University of Chicago Press, 1994.

<sup>2</sup> Coles, Colin, "Developing professional judgment." Journal of Continuing Education in the Health Professions 22.1 (2002): 3-10., p 5.

<sup>3</sup> Tripp, David, "Critical Incidents in Teaching" (Classic Edition): Developing Professional Judgement., p. 137, Routledge, 2011.

<sup>4</sup> Coles, Colin. "Developing professional judgment." Journal of Continuing Education in the Health Professions 22.1 (2002): 3-10., p 5.

<sup>5</sup> Carr, Wilfred, "For education: towards critical educational inquiry". p 59, Buckingham, UK: The Open University, 1995.

<sup>6</sup> Grundy, Shirley, "Curriculum: product or praxis?", p 280, Brighton, UK: Falmer, 1987.

<sup>7</sup> Fish, Della, Coles, Colin. "Developing professional judgment in health care: learning through the critical appreciation of practice", p. 280, Oxford, UK: Butterworth-Heinemann, 1998.

## 2. Accounting professionals.

Forming the accounting type of professional judgment at a global level is based, accordingly to the guide issued by the Institute of Authorized Accountant of Scotland (ICAS), on several principles<sup>8</sup>:

### – Principle 1: Knowledge gathering and analysis

An accounting professional judgment can be issued only after the collection and analysis of data. In order to better understand the purposes, legal framework and economic substance of the transactions, the accounting practitioner must go through several stages:

- Reading the relevant documentation
- Taking into consideration the cash-flows expected from the transaction and the impact on the entity's cash.
- Establishing the purpose to be pursued on each part involved in the transaction in order to understand the economical reality
- The identification of affiliated transactions that must be performed in order to establish the economical substance
- Taking into consideration the uncertainties and the possible range of result from the transaction
- Identifying the effect of the concluded transaction on the assets and liabilities of the entity and also over the operational capacities.

### – Principle 2: Assessment of accounting guidance

An accounting professional judgment can be issued only within an accounting applicable framework with extended applicability

In the absence of relevant standards or in the case of a conflict generated by the notions found in more than one standard the following actions are in place:

- Consultation of the conceptual framework for the general principles regarding the definition, recognition and measurement of assets, liabilities, revenues and expenses;
- Consultation of law regulated accounting documents for additional guidance;
- Establishing the existence of general valid accounting practice.

### – Principle 3: Process for making a judgement

An accounting professional judgment can be issued only after certain demarches with an equitable character, high accurate and concrete have been carried out taking into consideration the following aspects:

- Taking into consideration and evaluate the pallet of alternative accounting methods;
- Allocation of sufficient time for consulting the experts;
- Elimination of own conflicts of interest, of bias and misconceptions in order to ensure an objective

judgment;

- Organization of meetings designed to support the decision taking with professional advisors, auditors and other personnel that have the ability to support the decision making.

- Initiation of approval procedures for the judgments made by superior forums.

- Identifying the time intervals at the end of which a reevaluation of the professional judgment is required. For example: at the end of the financial period or before concluding new agreements.

### – Principle 4: Documentation of judgment

An accounting professional judgment implies proper documentation.

The entity must provide the following documentation regarding the accounting professional judgment:

- Presentation of the transaction;
- The accounting laws to be taken into consideration;
- Professional judgment used – final decision;
- Time given for taking the decision;
- Presentation of all alternative options and justification of the final option taken;
- Expressing, if applicable, the uncertainty of the decisional process;
- The sensitivity of the accounting professional judgment to changes that can occur in hypothesis or circumstances related to the transaction;
- The demarche carried on prior to a decision take: highlighting the sources used, discussions carried forwards (when, where and with whom), noting the person/entity that takes the decision and the date at which this process ended;
- Approval of demarches regarding the decisions: who approved and when;
- When it is necessary the reevaluation of the professional judgment and in what period.
- Presentation of the closeout regarding accounting significant judgment.

Objectivity – as a fundamental principle of ethics in the accounting profession states that an accounting professional must carry its activity impartially by elimination of all intrusions regarding misjudgments, bias, conflicts of interest or compatibility, confusions of unwanted influences that could intervene in the professional or business judgments.<sup>9</sup>

The International Accounting Standard (IAS) 1 presentation of financial statements mentions the use of professional judgment in the following situations:

- For the determination of the best presentation method of the information regarding the name of the reporting entity, the way the financial statements are referring to a group of entities of an individual entity,

<sup>8</sup> “A Professional Judgement Framework for Financial Reporting - An international guide for preparers, auditors, regulators and standard setters” published by the Technical Policy & Services Board of The Institute of Chartered Accountants of Scotland (ICAS), p. 8, August 2012.

<sup>9</sup> “Codul Etic Național al Profesioniștilor Contabili”, Ediția a V-a, revizuită și adăugită în conformitate cu Codul Etic Internațional al Profesioniștilor Contabili elaborat de IFAC, revizuit în iulie 2009, Colecția Doctrină – Deontologie, Editura CECCAR, București, 2011.

date of the balance sheet or the period regarding the issue of the financial statements, the presentation currency and the decimals used for the amounts stated in the financial statements. „For example, when an entity presents the financial statements electronically, separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood. An entity often makes financial statements more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the entity discloses the level of rounding and does not omit material information.”<sup>10</sup>

- In the eventuality of separate presentation of additional elements, the professional judgment is based on “the nature and liquidity of assets; the function of assets within the entity; and the amounts, nature and timing of liabilities.”<sup>11</sup>

- In the classification by destination of expenses when an entity presents separately cost of sales from the other expenses.<sup>12</sup>

- An entity has the obligation to present the summary of its significant accounting policies or in the other notes the professional judgment made by the management in applying the accounting policies and the effects it has over the amounts stated in the financial statements.<sup>13</sup>

- In the application of an entity’s accounting policies, the management uses professional judgment in order to determine: „(a) whether financial assets are held-to-maturity investments; (b) when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities; (c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and (d) whether the substance of the relationship between the entity and a special purpose entity indicates that the entity controls the special purpose entity.”<sup>14</sup>

- The information regarding the main hypothesis regarding the following periods and regarding other sources of uncertainty over the estimates at the balance sheet’s date require subjective professional judgment made by the management of the entity.<sup>15</sup>

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors mentions the use of professional judgment in the following situations:

- In the absence of a standard or applicable

interpretation in a specific manner over a transaction or another event, the management must use professional judgment in order to issue and apply an accounting policy that contains viable and relevant information that comply with the provisions and guidance of the standards, with definitions, criteria of recognition etc. from the general framework.<sup>16</sup>

- For the estimation of elements from the financial statement that cannot be evaluated with accuracy due to inherent commercial activity’s uncertainty. The estimation are based on information available at the latest.<sup>17</sup>

- IAS 16 Property, Plant and Equipment mentions the used of professional judgment in the following situation:

- In the recognition of fixed assets in accordance with the specific circumstances of an entity ( in some cases it will be appropriate to aggregate insignificant individual elements, such as molds, measure and control equipment, tools and other similar elements and to apply recognition criteria of the aggregated value of the above mentioned<sup>18</sup> )

- In estimation of useful lives of assets, the professional judgment is applied in accordance with the experience of the entity with a similar asset. „The useful life of an asset is defined in terms of the asset’s expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.”<sup>19</sup>

- When choosing the depreciation methods and in the useful life assessment of assets. „Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities.”<sup>20</sup>

IAS 21 The Effects of Changes in Foreign Exchange Rates mentions the use of professional judgment in determining the functional currency that presents the most accurate the economic effects of events, transactions and common conditions when this currency is not obvious.<sup>21</sup>

<sup>10</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 47 and art. 48, p. 7.

<sup>11</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 72, p. 11.

<sup>12</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 92, p. 14.

<sup>13</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 113, p. 17.

<sup>14</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 114, p. 17.

<sup>15</sup> International Accounting Standard 1 - Presentation of Financial Statements, art. 118, p. 18.

<sup>16</sup> International Accounting Standard 8 - Accounting Policies, Changes in Accounting Estimates and Errors, art. 10 și 11, p. 37.

<sup>17</sup> International Accounting Standard 8 - Accounting Policies, Changes in Accounting Estimates and Errors, art. 32, p. 41.

<sup>18</sup> Delia Mircea, coordonator editorial al Contzilla.ro cu certificare ACCA, “Utilizarea raționamentului profesional în contabilitate- 3 situații”, <http://www.contzilla.ro/utilizarea-rationamentului-profesional-in-contabilitate-3-situatii/>, accesat on February 12, 2015.

<sup>19</sup> International Accounting Standard 16 - Property, Plant and Equipment, art. 57, p. 86.

<sup>20</sup> International Accounting Standard 16 - Property, Plant and Equipment, art. 75, p. 89.

<sup>21</sup> International Accounting Standard 21 - The Effects of Changes in Foreign Exchange Rates, art. 12, p. 152.

IAS 23 Borrowing Costs mentions the use of professional judgment in determining the borrowing costs that can be directly attributable to an asset with a long production cycle asset<sup>22</sup>.

IAS 29 Financial Reporting in Hyperinflationary Economies refers to the use of professional judgment at the time it is needed to restate the financial statements. Professional judgment is applied also in restating the financial statements along the involvement of other procedures.<sup>23</sup>

IAS 34 Interim Financial Reporting mentions the use of professional judgment in the evaluation of the materiality threshold "to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period."<sup>24</sup>

According to IAS 36 Impairment of Assets the identification of an asset's cash-generating unit involves use of the professional judgement."<sup>25</sup>

According to IAS 37 Provisions, Contingent Liabilities and Contingent Assets the professional judgment of the entity's management determines the estimates of results and financial effects along with the support of independent experts and with the experience of similar transactions.<sup>26</sup>

IAS 38 Intangible Assets refers to the use of professional judgment in establishing whether an asset that comprises both tangible and intangible elements is a tangible or intangible asset. „For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset."<sup>27</sup>

IAS 39 Financial Instruments: Recognition and Measurement states that „in some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, an entity uses its experienced judgement to estimate the amount

of any impairment loss. Similarly an entity uses its experienced judgement to adjust observable data for a group of financial assets to reflect current circumstances"<sup>28</sup>

IAS 40 Investment Property mentions that professional judgment is used in assessing whether a real-estate property is a real-estate investment or not (the entities establish the criteria) and in order to assess which of the real-estate properties meet the conditions to be restated as real-estate investment.<sup>29</sup>

### 3. Conclusions

"In a market economy in which competition is the main selection criterion for companies, decision taking concerning the financing sources is an extremely difficult process."<sup>30</sup>

The professional judgments will always influence the decisional mechanism both by the conjunctions created and by returns "that means that there is a difference in size and hence a difference in importance"<sup>31</sup> when the future evolution of companies is taken into consideration.

Accounting professionals represent one of the most important categories of practitioners due to the fact that their professional judgments serve as material support for the activities carried forward by financial analyst, auditors and other categories of general practitioners.

Professional judgment is a concept that completes the activity of all practitioners.

This type of judgment appears at helping element of high importance in the decision-making process.

The intervention of this type of judgment represents and extension of decision taking power of the practitioner, the practitioner having the possibility to highlight his main native skills or practice accumulated skills.

The professional accountant used all categories of material elements transposed in laws, specific Codes, job descriptions, internal regulations, procedures; in the absence of such express regulations the professional judgment is used as a principal or auxiliary instrument.

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<sup>22</sup> International Accounting Standard 23 - Borrowing Costs, art. 14, p. 161.

<sup>23</sup> International Accounting Standard 29, art. 10, p. 189.

<sup>24</sup> International Accounting Standard 34 - Interim Financial Reporting, art. 25, p. 241.

<sup>25</sup> International Accounting Standard 36 - Impairment of Assets, art. 68, p. 256.

<sup>26</sup> International Accounting Standard 37 - Provisions, Contingent Liabilities and Contingent Assets, art. 38, p. 279.

<sup>27</sup> International Accounting Standard 38 - Intangible Assets, art. 4.

<sup>28</sup> International Accounting Standard 39 - Financial Instruments: Recognition and Measurement, art. 62.

<sup>29</sup> International Accounting Standard 40 - Investment Property, art. 14.

<sup>30</sup> Sudacevschi, Mihaela, "Financing Sources for Companies and the Implications on Their Image.", Lex ET Scientia International Journal (LESIJ) XVI-1 (2009): 324-331.

<sup>31</sup> Ionescu, Adela, "The European Banking System. Track Record And Achievement.", Global Economic Observer 2.2 (2014): 093-102.

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