

# HARMONIZATION, HISTORICAL COST AND INVESTMENTS

Valentin Gabriel CRISTEA\*

## Abstract

*Choosing depreciation of assets; revaluation of tangible or keeping their historical cost; registration, whilst the tangible assets are entered in the conservation of amortization expenses or a corresponding adjustment to depreciation expense ascertained; choosing the method of evaluating stocks is accounting policies. IAS 40 is significant because it was the first time the International Accounting Standards Board has introduced a fair value accounting model for non-financial assets. All firms must provide fair value for their real estate assets either directly in the balance sheet in accordance with the fair value model choice, either in the footnotes below cost model selection.*

**Keywords:** *Harmonization, historical cost, investments, fair value.*

## 1. Introduction

Fair value accounting was developed in Financial Accounting Standards Board (FASB) 157 by Landsman (2006); Maines and Wahlen (2006); Owusu-Ansah and Yeoh (2006); Bahal et al. (2008); Christensen and Nikolaev (2008); Muller et al. (2008); Peng in (2008).

Fair Value Accounting FVA is defined as the price that would be received to sell an asset or paid to transfer a liability for an orderly transaction between market participants at the measurement date. Bahal et al., (2008) deems fair value more relevant and reliable than historical cost. The application of FVA is more complicated because of its complex and controversial side. Muller et al. (2008) study the fair value of investment properties while studying the properties of the article of European companies listed on the real estate market in China. Agency theory is detected by the extent and determinants of investment properties valuation based companies listed on the stock exchange in Romania. A study of Taplin, Wei Yuan and Alistair Brown (2014) are based on construction based mainly on Western countries' ideas of a market-oriented study and can be applied in China. Ke & White (2009) states that the property market in China have rapidly been expanded and Li et al., (1999) have showed that a high percentage of foreign investment in China dedicated properties in cities in China. Wang et al., (2009) state that a huge pool of quality investment property is currently owned by commercial banks, developers, and government of China. What in Romania can speak only of Banca Transilvania SA, Bucharest Stock Exchange SA, Property Fund SA and BRD Groupe Societe Generale as main actors on the Romanian stock market with increases of 0.41% and respectively 1.12% and decreases 1.32% and respectively 0.19%

on 03/11/2016. Quek and Ong (2008) notes that China's economy surpassed most developed economies in the world leading to the rapid growth of real estate market in China. Chinese real estate market is dominated by real estate investment trusts (REITs). This is explained by the fact that the Chinese economy has exceeded the more developed economies in the last ten years, which is reflected by the rapid growth of real estate market in China (Quek and Ong 2008), which we can not talk of Real Estate Investment Trusts in Romania.

### 1.1. The question of the research topic

We note that important cultural and legal differences in property investments made by Chinese and Western companies. Nobody has the right to land ownership in China because it is an active state. It may be intangible value associated with land that welcomes rather than the building itself, which stands as a physical object that depreciates mostly by aging. Deloitte<sup>1</sup> (2011) recognizes that while transparency in contracts for real estate investment market in China has improved in recent years, there are still some issues that have an impact on the background check calendar periods and contractual transaction costs.

These problems include the lack of accurate property sales and leasing, transaction data, the lack of statistics on supply and demand for investment goods and the lack of centralized data on real estate investments. This makes empirical evaluation of Chinese companies applying either for real estate investments on historical cost or fair value accounting FVA and to ask a question. This is observed in Romanian companies. The problem of research is expressed as:

Features Romanian companies using fair value accounting are much different than those that use historical cost accounting for real estate investments?

\* PhD Candidate, Faculty of Economic Science, "Valahia" University of Targoviste (e-mail: [valentingabrielc@yahoo.com](mailto:valentingabrielc@yahoo.com)).

<sup>1</sup> Deloitte 2011, *China real estate investment handbook*, Deloitte Touche Tohmatsu, Beijing.

This paper is presented in three sections: Section 1 is Introduction, Section 2 provides literature review, data assumptions and research methods and conclusions as Section 3 .

## 2. Literature review, data assumptions and research methods

Filds et al. (2001) present more research regarding the accounting policy choice. A considerable interest is generated by economic implications of accounting elections among some researchers (Fields et al. 2001). There are economic incentives for managers selecting accounting techniques that can generate revenue growth or a decrease in revenue (Watts and Zimmerman, 1986; Skinner 1993). Economic factors of a positive outlook accounting theory are used to explain the election management accounting policies. This study presents the accounting regulations of OMFP 1802 (2014) of Romania. As FVA is a major component of International Financial Reporting Standards (IFRS), the findings provide insights on global challenges to the international accounting convergence. To promote convergence between national and international standards, OMFP 1802 (2014) is an internal standard issued to comply with IFRS 13. Investment property presents the perspective in this convergence.

IAS 40 Investment property is defined as property (land or a building - or part of a building - or both) held (by the owner or lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than: (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business. (IAS 40.5).

IAS 40 Investment Property Finns propose to choose between cost and fair value models and apply the policy chosen all their property investment. Under the cost model, companies that apply the requirements of IAS 16 Property, Plant and Equipment (IAS 40.56) on this method, according to which real estate investments are carried at its cost less any accumulated depreciation and any accumulated impairment loss (IAS 16.30). However, the fair value must be disclosed in footnotes, unless, in exceptional circumstances, fair value can not be determined reliably (IAS 40.79 (e)).

Under the fair value model, investment property is carried in the balance sheet at fair value (IAS 40.33), with all changes in fair value reported in profit (IAS 40.35). The fair value of investment property is the price at which the property could be exchanged between knowledgeable parties concerned in arm's length transactions (IAS 40.5).

It will be determined in accordance with a fair value hierarchy described in IAS 40.45-47, where the best evidence of fair value is given by current

prices in an active market for similar properties in the same location and condition and subject similar lease and other contracts. The companies must hire independent experts (eg assessors), with qualifications and relevant experience in order to establish fair value (IAS 40.32).

IAS 40 is significant because it was the first time the International Accounting Standards Board (IASB) has introduced a fair value accounting model for non-financial assets. All firms must provide fair value for their real estate assets either directly in the balance sheet in accordance with the fair value model choice, either in the footnotes below cost model selection.

However, given that only gains resulting from the fair value model or the fair value of unrealized losses streams of income, the choice between the two models affect reported net earnings and volatility in asset values. The standard specifies that firms are able to shift from cost model to fair value model. The standard explicitly states that the presentation will be prohibited by a switch from fair value to cost model (IAS 40.30).

The historical cost is an accounting convention involves recording assets at their purchase or production while the claims and liabilities are recorded at their nominal value.

Short-term securities represent shares and other financial investments. They are admitted to trading on a regulated market and an estimated value of trading on the last day of trading, and those traded is estimated at cost less any adjustments for impairment.

Long-term securities are shares and other financial investments. They are estimated at historical cost, without any adjustments for impairment.

The accounting policies contain principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Choosing depreciation of assets; revaluation of tangible or keeping their historical cost; registration, whilst the tangible assets are entered in the conservation of amortization expenses or a corresponding adjustment to depreciation expense ascertained; choosing the method of evaluating stocks represent accounting policies.

Non-monetary items such as fixed assets, stocks, purchased with payment in foreign currency and recorded at historical cost will be presented in the financial statements using the exchange rate at the date of the transaction.

In the notes to be presented at historical cost value of revalued assets and the amount of cumulative value adjustments; or at the balance sheet value of the difference between unrealized gains and representing the historical cost and, where appropriate, the cumulative amount of the additional

value adjustments. separately for each item in the balance of nature revalued property and equipment when making revaluation.

Williams (2003), Watts and Zimmerman, (1986) showed that positive accounting theory has contributed significantly to the understanding of corporate reporting practices.

Agency theory, an important building of positive accounting theory, was a popular concept for researchers interested in the choice of accounting problems and incentive mechanisms for dealing stimulation (Guilding et al. 2005).

Accounting is a link between the choice of accounting records and leverage and firm size Christensen, HB and Nikolaev, V (2008), Gopalakrishnan (1994), Kalay (1982). EFET leverage increases by raising capital. Fields et al. (2001), and Watts and Zimmerman (1986). show leverage can be reduced through management techniques. We hypothesize that:

H1: Companies with less leverage are more likely to use historical cost model.

Ball (2006) and Jermakowicz and Gorn Tomaszewski (2006) shows that revenues are volatile consequence the introduction of fair value due to external economic factors control the companies: changing market prices of assets (Ronen 2008; Whittington 2008).

This volatility is one of the main arguments against fair value method (Enria, et al.2004) volatility direct capital cost (Fama 1977).

Agency theory shows that managers must provide holders of debt next low volatility of earnings (Watts and Zimmerman 1990).

Muller et al. (2008) show that there is a link between the adoption of fair value beneficial and cost of capital. We hypothesized:

H2: Companies with less variability of revenues reported are more likely to use historical cost model.

Romanian companies can list domestically or abroad where additional investments can boost Romanian market entities play a global role by reporting at fair value (McCollum 2006). Thus we hypothesize:

H3: Romanian companies unlisted on the international stock market are more likely to use historical cost model.

Agency theory finds the information asymmetry as one of the key factors that allows management to pursue objectives that are divergent from the interests of shareholders (Watts and Zimmerman 1990). Managers to protect the company's shareholders choose models cost value fair and efficient. We consider efficient historical cost. We issue the hypothesis:

H4: Small companies without being listed on the exchange stock market are more likely to use historical cost model.

Investment firm have lower cost of information on local real estate markets in relation to non-local markets (Muller et al., 2008) .We hypothesize:

H5: Companies with nationwide operations more likely to use historical cost model.

We get a research from BVB (Bursa de Valori București) Bucharest Stock Exchange at 3/11/2016. BET Index Composition<sup>2</sup> 3/11/2016

SSymbol	Company	Shares	Ref. price	FF	FR	FC	Weight (%)
TTLV	BANCA TRANSILVANIA S.A.	3,026,003,679	22.4300	00.90	00.863000	11.000000	21.45
FFP	FONDUL PROPRIETATEA	11,193,423,051	.07450	11.00	00.625000	10.000000	19.57
SNP	OMV PETROM S.A.	56,644,108,335	00.2550	0.30	11.000000	11.000000	16.27
SSNG	S.N.G.N. ROMGAZ S.A.	385,422,400	26.8500	00.30	11.000000	11.000000	11.66
BRD	BRD GROUPE SOCIETE GENERALE S.A.	696,901,518	10.5800	00.40	11.000000	11.000000	11.08
EL	ELECTRICA SA	345,939,929	12.3000	00.50	11.000000	11.000000	7.99
TGN	S.N.T.G.N. TRANSGAZ S.A.	11,773,844	2266.0000	00.50	11.000000	11.000000	5.88

<sup>2</sup> <http://www.bvb.ro/FinancialInstruments/Indices/IndicesProfiles.aspx?i=BET>

TEL	C.N.T.E.E. TRANSEL ECTRICA	73,303,1 42	229.5500	00.50	11.000000	11.000000	4.07
SNN	S.N. NUCLEAR ELECTRIC A S.A.	1,221,041	.5.4900	00.20	11.000000	11.000000 <sup>1</sup>	1.24
BVB	BURSA DE VALORI BUCURES TI SA	7,674,198	227.2000	11.00	11.000000	11.000000	0.78
FF = Free Float Factor	FR = Representati on Factor	FC = Price Correction Factor		FL = Liquidity Factor			
Index capitalization: 26,626,283,028.62 RON							
Index Divisor: 4,029,956.1575							

We note that 40% of companies listed on BVB are investment funds and properties. More than 50% of Romanian companies are using historical cost.

### 3. Conclusions

Romanian companies use historical cost if they are unlisted on the international stock market H3 or they are small and unlisted on stock market H4, or with less variability of revenues reported H2, or with nationwide operations H5, or with less leverage H1

We remark that 40% of companies listed on BVB are investment funds and properties. More than 50% of Romanian companies are using historical cost.

Listing status of a Romanian company is affected by the company's investment property foundation selection.

Romanian companies have choices to list domestically or internationally.

If a company is unlisted international, it is better to use historical cost accounting as a basis valuation.

Small companies with nationwide operations and unlisted on the exchange stock market are more likely to use historical cost model.

If a company has less variability of revenues reported, it is better to use historical cost accounting as a basis valuation.

If a company has less leverage, it is better to use historical cost accounting as a basis valuation.

### References:

- Ball, R., "Intenational Financial Reporting Standards (IFRS): Pros and cons for Investors", *Accounting and Business Research, International Accounting Policy Forum*, (2006) 5-27;
- Bahal, A, Larson, E, Cristiano, J and Sen, V, "Transactions Advisor Services: Dealing with Fair Value - Volatility; in the Near Term", (2008) Viewed 20 Feb 2013, <http://ftimedia.fticonsulting.com/resources/documents/trendwatch-june08.pdf> ;
- Christensen, HB and Nikolaev, V. "Who Uses Fair-Value Accounting for Non-Financial Assets Following IFRS; Adoption", (2008) Viewed 6 March 2014, <http://faculty.chicagobooth.edu/valeri.nikolaev/PDF/Christensen%20and%20Nikolaev%202011%20Does%20fair%20value%20accounting%20for%20nonfinancial%20assets%20pass%20the%20market%20test.pdf>;
- Deloitte, *China real estate investment handbook*, Deloitte Touche Tohmatsu, (2011) Beijing.;
- Enria, A., Capiello, L., Dierick, F., Grittini, S., Haralambous, A., Maddaloni, A. Molitor, P. A.M., Fires, F. and Poloni, P., "Fair Value Accounting and Financial Stability" (ApHl). ECB Occasional Paper no. 1 3 (2004) Viewed 20 Feb 2013, <http://ssrn.com/abstract=749044>;
- Fama, E. F., "Risk-Adjusted Discount Rates and Capital Budgeting under Uncertainty", *Journal of Financial Economics*, vol. 5, no. 1, (1977) 3-24;
- Fields, TD Lys, TZ and Vincent, L, "Empirical Research on Accounting Choice", *Journal of Accounting and Economics*, vol. 31, no. 1-3, (2001) 255-307 ; [http://dx.doi.org/10.1016/S0165-4101\(01\)00028-3](http://dx.doi.org/10.1016/S0165-4101(01)00028-3);
- Gopalakrishnan, V., "Accounting Choice Decisions and Unlevered Firms: Further Evidence on Debt/Equity Hypothesis, *Journal of Financial and Strategic Decisions*, vol. 7, no. 3, (1994) 33-47;
- Guilding, C, Wamken, J, Ardill, A, and Fredline, L., "An Agency Theory Perspective on the Owner/Manager Relationship in Tourism-Based Condominiums", *Tourism Management*, vol. 26, no. 3, (2005) 409-420; <http://dx.doi.org/10.1016/j.tourman.2003.11.021>;
- Jermakowicz, EK and Gomik-Tomaszewski, S, "Implementing IFRS from the perspective of EU publicly traded companies", *Journal of International Accounting, Auditing and Taxation*, vol. 15, no. 2, (2006) 170-196; <http://dx.doi.org/10.1016/j.intaccaudtax.2006.08.003>;

- Kalay, A, "Stockholder-bondholder conflict and dividend constraints", *Journal of Financial Economics*, vol. 10, no. 2, (1982) 211-233. [http://dx.doi.org/10.1016/0304-405X\(82\)90014-9](http://dx.doi.org/10.1016/0304-405X(82)90014-9);
- Ke, Q and White, M., "An econometric analysis of Shanghai office rents", *Journal of Property Investment & Finance*, vol. 27 no. 2, (2009) 120-139. <http://dx.doi.org/10.1108/10.1108/i.4635780910937836>;
- Maines, LA and Wahlen, JM, "The nature of accounting information reliability: inferences from archival and experimental research", *Accounting Horizons*, vol. 20, no. 4, (2006) 399-425; <http://dx.doi.org/10.2308/acch.2006.20.4.399>;
- Landsman, WR, "Fair Value Accounting for Financial Instruments: Some Implications for Bank Regulation", Bank for International Settlements Paper No. 209, (2006) Viewed at 6 March 2014, <http://www.bis.org/publ/work209.pdf>;
- Li, L, Tse, R and Ganesan, S., "Shanghai", in J Berry & S McGreal (eds). *Cities in the Pacific Rim: Planning Systems and Property Markets*, (E & FN Spon, London, 1999) 45-66;
- McCollum, T., "China adopts international standards", *Internal Auditor*, Vol.63(2), (2006) 21;
- Müller, K, Riedl, E and Sellhom, T., *Consequences of Voluntary and Mandatory Fair Value Accounting: Evidence Surrounding IFRS Adoption in the EU Real Estate Industry*: Working Paper 09-033, Harvard Business School, Boston (2008);
- Owusu-Ansah, S and Yeoh, J., "Relative value relevance of alternative accounting treatments of unrealized gains: implications for the IASB", *Journal of International Financial Management and Accounting*, vol. 17, no. 3, (2006) 228-255; <http://dx.doi.org/10.1111/j.1467-646X.2006.00128.x>;
- Quek, CH and Ong, SE., "Special Considerations for Designing Pilot REITs in China", *Journal of Property Investment & Finance*, vol. 26 no. 3, (2008) 247-274; <http://dx.doi.org/10.1108/14635780810871623>
- Ronen, J, "To Fair Value or Not to Fair Value: A Broader Perspective", *Abacus*, vol. 44, no. 2, (2008) 181-208, <http://dx.doi.org/10.1111/j.1467-6281.2008.00257.x> ;
- Skinner, DJ., "The Investment Opportunity Set and Accounting Procedure Choice: Preliminary Evidence", *Journal of Accounting & Economics*, vol. 16, (1993) 407-445, [http://dx.doi.org/10.1016/0165-4101\(93\)90034-D](http://dx.doi.org/10.1016/0165-4101(93)90034-D);
- Stefan-Duicu, V. M. and Stefan-Duicu, A., "Global Analysis of the Financial Analyst's Job within a Company", *Procedia Economics and Finance*, 26, (2015) 261-267 ;
- Stefan-Duicu, A. and Stefan-Duicu, V. M., "Development and Regulatory Factor of Professional Bodies in the Audit Activity", *Procedia Economics and Finance*, 26, (2015) 268-271.
- Taplin, RH., "A unified approach to the measurement of international accounting harmony", *Accounting and Business Research*, vol. 34, no. 1, (2004) 57-73;
- Taplin, Wei Yuan and Brown, Use of Fair Value and Historical Cost in China, *Australasian Accounting Business & Finance Journal*, Volume 8, no. 1, (2014) 101-113;
- Wang, H, Sun, Y and Chen, Y., "Special considerations for designing pilot REITs in China", *Journal of Property Investment & Finance*, vol. 27 no. 2, (2009) 140-161, ; <http://dx.doi.org/10.1108/14635780910937845>;
- Watts, R and Zimmerman, JL., "Positive Accounting Theory: A Ten Year Perspective", *The Accounting Review*, vol. 65, no. 1, (1990) 131-156;
- Watts, R and Zimmerman, JL., *Positive Accounting Theory*, Prentice-Hall, Inc. Englewood Cliffs, New Jersey (1986);
- Whittington, G., "Fair Value and the IASB/FASB Conceptual Framework Project: An Alternative View", *Abacus*, vol. 44, no. 2, (2008) 139-178, <http://dx.doi.org/10.1111/j.1467-6281.2008.00255.x>;
- Williams, PF., "Modern Accounting Scholarship: The Imperatives of Positive Economic Science", *Accounting Forum*, vol. 27, (2003) 251-269, <http://dx.doi.org/10.1111/1467-6303.00105>;
- <http://www.bvb.ro/FinancialInstruments/Indices/IndicesProfiles.aspx?i=BET>