ACCOUNTING HARMONIZATION AND HISTORICAL COST ACCOUNTING

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Abstract

There is a huge interest in accounting harmonization and historical costs accounting, in what they offer us. In this article, different valuation models are discussed. Although one notices the movement from historical cost accounting to fair value accounting, each one has its advantages.

Keywords: *Accounting harmonization, accounting regulation, historical cost accounting, revaluation model, IFRS, fair value accounting.*

1. Introduction

Major factor that affects a system of accounting regulation is legal system. Continental Europe is based on Rome Civil Law, where one can see a direct regulation of accounting throughout acts, decrees and various accounting standards. This direct regulation makes to exist a connection between accounting and taxes [1]-[6]. Accounting regulation is in such a case unified and cannot bring some additional effects for specific financial statement users. Anglo-Saxon manner is directed on common law.

Regulation is principle based on the requirements that are defined by professional institution in the shape of accounting standards. State plays the crucial role in direct system of accounting regulation. Above mentioned manner is intense for the training and education of professional accountants. This manner is constructive to accounting practices [7], [8].

Researchers and practitioners have discussed and have stated about measuring of balance sheet items. There are very important inadequacy and inconsistencies in presented information at the application of various measuring bases.

Accounting theory and practice has established quite a wide range of possible manners to the measuring in accounting. Accounting data must be based on reliability, clarity, and comparability manners to measuring in accounting a significant part of the regulation of accounting both at the national level and within international accounting harmonization. When it standardizes the output of accounting, which is characteristic for Anglo-Saxon area, or when it standardizes current accounting practices and the related regulation of financial reporting used in continental Europe, there are always specific rules set, adjusting the measuring used or accounting of transactions during the reporting period as well as the measuring for the preparation of financial statements[1] [10].

Accounting rules are theoretically based on the choice of setting a single measuring basis, which would be usualy used in measurings in all situations, or may use mixed measuring manners[2] [11].

Accounting practices used by International Financial Reporting Standards (IFRS) are characteristic the use of mixed measuring manners. Recently, there is an effort of the International Accounting Standard Board (IASB) to enhance a single measuring manner.

According to Dean[3] [12] there exists much concern about the current mixed measuring model, which uses fair value and cost within financial statements[4] that is not the most preferred or perhaps reliable basis of accounting. Choosing an suitable solution shows up difficult[5].

2.1. Measuring Manners

The starting point can be established for the purpose of measuring that (according to the standard setters) best satisfies the norms of the financial accounting and reporting measuring. These estimation bases are the following: historical cost, replacement cost, value in use or fair value.

The objective must measure the selected measuring basis, other bases being allowed only as proxies where direct measuring was impossible[6] [13].

The consistency of the estimation, comparability and meaningful assemblage of the accounting data are the advantages of this manner. The adoption of single

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[1] J. Strouhal, Applicability of IFRS in the practice of Czech SMEs: Insight of Czech accounting profession representatives, in *Proc. The 9th International Conference on European Financial Systems,* Masaryk University Brno, 2012, pp. 214-219.

[2] J. Strouhal, Current Measurement tendencys in financial reporting: from historical costs towards fair value concept (and back)? in *Proc. International Conference on Communication and Management in Technological Innovation and Academic Globalization*, WSEAS Press, 2010, pp. 27.

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measuring method is predicated on the belief that such a measuring will be always the most relevant and will be reliably estimation.

Researchers are searching on perfect measuring basis. Macve[7] [16] thinks that it is impossible to prove that any individual measuring manner is Pareto superior to others for external users ideally they require a range of alternative estimates in order to triangulate the information they obtain from various sources. IASB tests to get and protect such a base in its projects dealing with measurings[8] [17]. According to the IASB's projects the fair value measuring should be such a base, however, in our opinion in many cases not even fair value meets the norms, which a measuring in financial accounting should meet.

As mensionated above, virtually all systems of accounting regulation (without exception of IFRS) do not currently use a single measuring manner, required and preferred in all cases, but the mix of measuring manners. The convenience of this manner is that it is not necessary to use a single measuring manner for all situations, which, regarding the information demands of users, but also for example the reliability of establishing such measuring might not be suitable in a particular situation.

Different scales for different reasons is adequate for financial accounting [18]-[20]. Cost measures may provide useful margins on turnover for predicting operating cash flows in a going concern business, whereas fair value may be a more direct and reliable means of valuing a portfolio of marketable investments.

However, drawbacks of using mix measuring manners are obvious – it leads to assemblage of the data measured by different manners, the explanatory power of such assemblage is weak, plus the use of different measuring manners entails various risks. To report the items which are measured by different measuring manners separately is therefore a minimum requirement, which should be held. Separate reporting of items bound to various estimating risks enables the users of financial information their independent analysis and assessment.

Measuring manners are in practice differentiated according to both the moment at which the measuring is performed (e.g. initial recognition of the particular item or subsequent measuring) and according to nature of the subject of the measuring (e.g. long-term assets in terms of meeting the prerequisites of going concern, inventories and derivatives or securities held for trading are measured differently.)

By accepting this manner the measuring problem has been limited to the search of an suitable measuring base for the measuring of particular items in a particular situation. Only one method of measuring would be associated with a particular item, different item would, or could, be measured using different methods, if those methods best represented the economic properties of the particular item [13].

The norms for the choice of the measuring manner are determined by standard setters. The starting point should always be the information demands of the users of financial information. However, there are different groups of the accounting information users that have different benefits and different demands. The final selection of the norms is always dependent on the decision of the standard setters, who may and in fact must give priority to the benefits of certain groups of the accounting information users[9] [20].

If the accounting regulator is the state – a state institution (what is common in continental Europe) and if there is a close relation between accounting and taxation in the country given, the norms for the selection of the measuring manner may be strongly affected by the fiscal benefits of the state (accounting is then adjunct to the tax aspects) and other demands of the state administration (a crucial source of demand for accounting information is the state), and the benefits of other users of accounting information may not be adequately taken into account. This method of accounting regulation is often characterized by the usually not explicitly formulated basic objectives of financial reporting or conceptual framework.

Continental Europe is also characterized by the strong influence of the prudence principle in choosing the suitable measuring manner (manners). It was this principle together with the possibility to partly ignore the benefits of the users of accounting information (investors, etc.) which is given by the fact that accounting rules are set by a government organization, which significantly affected the norms for selecting measuring bases and blocked or hindered the penetration of the measuring in fair value to accounting (as an example we can mention accounting in Germany or France). Another situation arises in case that setting the accounting rules is carried out by a professional organization (typical of the Anglo-Saxon area). This organization begins from the benefits of different groups of users (who in fact create a demand for accounting information) and tries to meet them suitably when creating accounting policies (including the definitions of measuring manners). The standard setters are, however even in this case before the difficult task of deciding which demands and benefits of users of accounting information it is necessary to prefer and how they are optimally met.

The representative of the regulation (harmonization) of accounting, which is not adjunct to the state power, is IASB (as well as the Financial Accounting Standards Board - FASB, UK Accounting Standards Board). The conceptual framework of the IFRS, based on the fact that the financial statements are

[7] R. Macve, The case for deprival value, *Abacus*, no. 46, pp. 111-119, 2010.

[8] IASB, Discussion Paper: Fair Value Measurement Part 1 – Invitation to Comment and Relevant IFRS Guidance, London: IASB, 2006.

[9] A. Tarca, International convergence of accounting practices: choosing between IAS and US GAAP, *Journal of International Financial Management and Accounting*, vol. 15, no. 1, pp. 60-91, 2004.

intended primarily to external users, analyzes the information demands of different groups and states:

While not all of the information demands of users can be met by financial statements, there are demands that are common to all users. As investors are providers of risk capital to the entity, the provision of financial statements that meet their demands will also meet most of the demands of other users that financial statements can satisfy[10] [21]. The measuring must be also adjunct to these goals.

In summary, the primary norms for evaluating possible measuring bases, derived from the conceptual frameworks, are:

1. Decision usefulness;
2. Qualitative characteristics of useful information;
   - Understandability;
   - Relevance — predictive value, feedback value, timeliness;
   - Reliability — representational faithfulness, neutrality, verifiability;
   - Comparability;
3. Concepts of assets and liabilities;
   - How the expected cash-equivalent flow attribute of assets and liabilities is measured;
4. Cost/benefit considerations.

2.2. Application

Within this application part we would try to analyze the implication of various measuring models: historical cost accounting, fair value accounting and revaluation model used for revaluation on selected financial ratios, concretely:

1. profitability ratios: ROA, ROE, ROS
2. liquidity ratios: current ratio
3. assets turnover ratios: assets turnover
4. debt ratios: debt ratio, Equity/Debts ratio, average, leverage, interest coverage, Assets/Debts ratio
5. capital markets ratio: EPS

A. Historical Costs Accounting

The most popular model in Western Europe is historical costs accounting. When applying this model, we have to satisfy the prudence principle perceptions and that's why we are unable to revaluate assets on higher values. When revaluating on lower values there is applied the computation of impairment.

Historical cost accounting provides us information about the effect of using historical cost model on profitability ratios, liquidity ratios and assets turnover ratio.

Historical costs accounting linearly behaves profitability and liquidity ratios. The inverse tendency is seen could be seen (however marginal) for assets turnover ratio.

Historical costs accounting, proportional tendency is visible within EPS analysis. All other ratios (with the exemption of debt ratio and financial leverage) show identical tendency, but less proportional. The inverse tendency of debt ratio and financial leverage could be explained by the fact that higher the value of these ratios, higher the debt exposure of the company.

B. Fair Value Accounting

Fair value accounting is currently used mainly for revaluation of selected financial instruments, investment properties and biological assets. Fair value accounting provides us information about profitability ratios, liquidity ratios and assets turnover ratio.

Fair value accounting behaves all profitability ratios in line with revaluation. Fair value model has marginal impact also on liquidity ratios and assets turnover, but these ratios show us inverse tendency.

Fair value accounting provides us information about the debt ratios and earnings per year.

Fair value accounting are the most sensitive ratios: EPS and interest coverage. Marginal influence of the revaluation is visible for Assets/Debts ratio and Equity/Debts ratio.

Debt ratio and financial leverage comport similarly and prove the inverse tendency against other financial measures. This inverse tendency is explicated by the fact that higher the value of these ratios, higher the debt exposure of the company.

C. Revaluation Model

Revaluation model is utilized for realizable financial instruments. When applying this model we also have to revaluate assets at fair value, however the revaluation does not have any impact on company's profit or loss, but onto other comprehensive income (being a part of equity).

Revaluation model provides us information about the profitability ratios, liquidity ratios and assets turnover ratio.

Revaluation model has any impact on ROS and current ratio. Revaluation model behaves ROE as well as other ratios (with less significant tendency) in inverse tendency.

Revaluation model provides us information about the debt ratios and earnings per year.

Revaluation model has any impact on ratios EPS and interest coverage. The linear tendency is visible for debt ratio and Equity/Debts ratios, however inverse tendency is visible for debt ratio and financial leverage. The inverse tendency is explicated by the fact that higher the value of these ratios, higher the debt exposure of the company.

[10] Bonaci C. G. and Strouhal, J.. Corporate governance lessons and traders' dilemma enhanced by the financial crisis, in *Proc. the 5th WSEAS International Conference on Business Administration*, WSEAS Press, 2011, pp. 66-69.

3. Conclusions

There is more visible the tendency of fair value accounting round-out-the world because of the increasing impact of harmonized accounting legislature (IFRS, US GAAP), but the historical cost accounting is very popular within continental European accounting systems. This tendency is explicated as a positive one, as one of the major premises for applying fair value or revaluation model is transparent active market. This cannot be claimed about emerging economies (e.g. in Central and Eastern Europe). Analysis of the impact of various models use for revaluation of assets on selected financial ratios proves us that these ratios are not very sensitive on revaluation model application, but on contrary, they are very sensitive on fair value accounting application.

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