THE TRANSITION FROM HISTORICAL COST TO FAIR-VALUE, A CHOICE WITH MAJOR IMPLICATIONS IN ACCOUNTING

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ABSTRACT: *This paper treats the importance of the transition from valuation at historical cost to valuation at fair value of the assets within an economic entity, and the contents of the result obtained in financial reporting. The work deals with the influence that the fair value assessment can have on the level of an entity's economic performance. Starting from a few statements such as: fair value option evaluation to influence significantly the fair value; presentation of the elements on the balance sheet at fair value leads to significant changes in the accounting of the economic entities, in data analysis was used a questionnaire based on the four questions whose results were analysed and which have led to carrying out this study. The research was supported by the information collected from individuals and companies within certain economic entities. The paper ends with the conclusions of authors related to the fair value assessment which, as if trying to address the shortcomings of historical cost, by aiming to correct cost of customer acquisition assets with market value, achieved through constant re-evaluation of the balance sheet items. On the other hand, a concurrent evaluation of both historical cost and fair value, depending on the inherent characteristics of the elements of the balance sheet, resulting in getting relevant, reliable financial statements, in accordance with reality.*

KEY WORDS: *historical cost; creation of value; assessment; fair view; accounting principles; accounting rules; financial situations; fair amount.*

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1. INTRODUCTION

About value has been written and talked much and from different positions towards defining it, versus its role in people's lives. In accounting, the value is seen as

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the result of the evaluation of assets, debts, and capital and reserves. Through value, the accounting uniforms assets, otherwise quite heterogeneous, in order to quantify the whole heritage. The method of calculating the value of own assets, debts, and capital have differed in time and space, the accounting seeking the most appropriate procedures for determining the value of the assets, aiming for "*playing fair*" and the results of the work carried out.

The assessed original cost, measured and recorded to the entry of assets and debts in the accounts is known as the historical cost. The historical cost is oriented towards the past, but unlike other assessment bases, presents the major advantage of being clearly defined and verifiable, and once established it remains fixed as long as the property is in possession of the respective economic entity. The historical cost accounting information is based on data relating to past events contained in supporting documents without reference to data on current market prices. Historical cost leads to a negative vision of the entity since, in accordance with the principle of prudence, this does not allow the recognition of the potential losses for assets and earnings.

Therefore, the historical cost accounts do not anticipate all the profits of the entity, but anticipates all losses. In the case of assets, the historical cost delimits the amount in cash or by cash equivalent paid at the time of purchase or the fair value of the amount paid at the time of purchase. Within the framework of normal business, if debt, the historical cost is the amount of cash equivalents obtained in exchange for the obligation or under certain circumstances (for example, in the case of corporation tax), the value of what is expected to be paid in cash or cash equivalents to extinguish debts. In order to be able to rely on the information provided by the producers of information, internal and external users must ensure that the information is verifiable and objective.

Or, just the use of the historical cost as the basis of measurement, enables manufacturers to provide verifiable information in financial statements and goals. Producers and users of financial statements have noted that, in measuring and presenting information, the historical cost would be most useful. Aristotle is that which has given a new dimension to value. The term value descended from the Latin etymological verb "valere", whose original meaning was: "*can, be powerful, procure satisfaction*". Value designates the stable qualities, perennial, empirically ascertainable of things. The philosophy is separating the two concepts relating to value: on the one hand axia - value, on the other hand timo - price. Scholastics economists have defined value by usefulness of the good, as well they are those who talk about the "exact price".

The exact price was the cost of production or current market price, the price given by a person who is unable to influence it. It was probably the earliest occurrence of the notion of fair value. The concept of fair value is broader and the more general utility than that of market value: indeed, in the absence of a market price noted in an active market, the evaluation shall be determined according to the value of the exchange on which the two independent parts agree, by the market price of an item with close features or by calculating the net present value of future flows. Attention on the fair value was determined by the financial crisis since 2008 that led to a major policy debate what involved both the United States Congress and the European

Commission, as well as the accounting and banking regulatory authorities around the world.

According to some specialists in the field, the fair value acted in two directions: on the one hand resulted in the onset and deepening the financial crisis, and on the other hand, it is considered that due to the use of the concept of fair value, the financial crisis could be identified much earlier, and some of its effects could be predicted. In our opinion, the fair value is not responsible for the emergence of the crisis nor is a system which declares that the assets would have economic effects. The fair value assessment involves a large number of non-financial assets and liabilities; it can be the basis of a new model of representation of economic entity whose objective will be to transpose better the financial situations, the uncertainty affecting the cash-flow forecasts and investment opportunities. It is possible that the preparation of individual accounts, because the consolidated accounts serve almost exclusively to shareholders and managers.

2. LITERATURE

The aim of this research was the issue of the transition from historical cost to fair value, both internationally and nationally, in the sphere of accounting research regarding accounting and financial reporting.

The present research was to attempt to answer questions such as:

- *"The accounting information provided by the financial statements is sufficient and relevant to the analysis of the transition from historical cost to fair value?";*
- *"What is the impact of the evaluation at fair value on the image of the entity's accounting?";*
- *"What are the factors that limit the use of fair value in the financial reporting framework?".*

The importance of the transition from the historical cost, to the fair value, evidenced by the very concerns of IASC/IASB bodies as well as the concerns of various national and international researchers in the field. With regard to the philosophy of the IASB regarding the normalization of accounting, in the literature, we note that this is axed with propensity on the consolidated accounts.

In the year 2001, under the Romanian rules it is spoken for the first time about the tendency of Romania to align international accounting regulations by using asset at fair value assessment, provision contained by OMFP 94/2001. Nationally, we mention Matiş and Mustaţă (2004) who considers that at present and in the near future we will witness a mixed evaluation model, which is characterised both by historical cost and fair value. Economic entities using historical cost as the basis of assessment due to tax reasons. The elaboration of the two sets of accounts (at cost and at fair-market value) does not find justification in all circumstances, if we take into account the cost-benefit analysis in producing accounting information.

Internationally, among supporters of fair value we remind Brown and Finn (1980) that highlight the importance of reassessment by defining it. Regarding their views, the reassessment is a new formulation of the accounting value of the tangible fixed assets for which there is no direct effect on the entity cash-flow. At the same time, they shall consider the matter from the perspective of a reassessment and its influence on the price action of an economic entity. They believe that this link between revaluation and value of an entity's action can be explained by understanding the purpose for which revaluation is done.

Basically, they believe that the incentive that motivates managers to make the voluntary revaluation of assets is just the effect of the revaluation on the value of the shares of the entity (value accounting math). At the same time, some English authors are of the opinion that the reassessment affects the costs of the economic entity, it representing the reason that managers are not indifferent to the manner and time of the reassessment of its assets. Under their personal view, revaluation of assets could help solve some problems caused by information asymmetry, i.e. managers could signal important information which they hold relating to the revaluation of the assets they control.

3. RESEARCH METHODOLOGY

Bearing in mind the targets, we achieved a questionnaire that has been applied to some economic entities, testing the reaction of the two categories of participants (shareholders and managers), in terms of:

- "*Is accounting information provided by the financial statements sufficient and relevant to the analysis of the transition from historical cost to fair value?";*
- *"What is the impact of the evaluation at fair value on the image of the entity's accounting?";*
- *"What are the factors that limit the use of fair value in the financial reporting framework?"*.

The importance of the transition from the historical cost, to the fair value, is evidenced by the very concerns of IASC/IASB bodies as well as the concerns of various national and international researchers in the field.

4. The qualitative characteristics of accounting information according to the conceptual accounting framework

In the life of an economic entity the dominant relationship is the relationship between its owners and managers. Internal users are represented by the managers. They resort to accounting information that reflects mining operations, investment, financing and treasury management for foundation and decisions. For this purpose, they use the information generated by both current accounts and disclosures in the annual financial statements or half-yearly/quarterly, as of the final accounting products.

Under the terms of the internationalization of Romanian accounting, managers have a major role in the election, namely: policies options definition most appropriate to accounting entities, in order to reflect the economic reality. Mandated by the owners to manage the wealth and activity of the economic entity, the managers have data supplied by financial accounting and management accounting (which are exclusively reserved for them). External users are represented by the economic entity funders, its commercial partners, social partners, public power and other external users. The funders are users, which potentially or actually, shall make available to an entity the economic resources for its activities.

The role of financial reporting is to generate useful information to users of financial statements. New version of conceptual accounting framework considers the most important category of users includes investors and lenders, and the financial statements must be addressed mainly to their needs. In the new version of the framework it is considered that the information needs of investors and creditors and other needs include user categories. Information provided by financial reporting must be useful to users, both internal and external, in investment and lending decisions.

The usefulness of accounting information is obtained through the achievement of qualitative characteristics. The general framework for the preparation and presentation of the IASB financial statements stipulate four main features as shown in Figure 1.

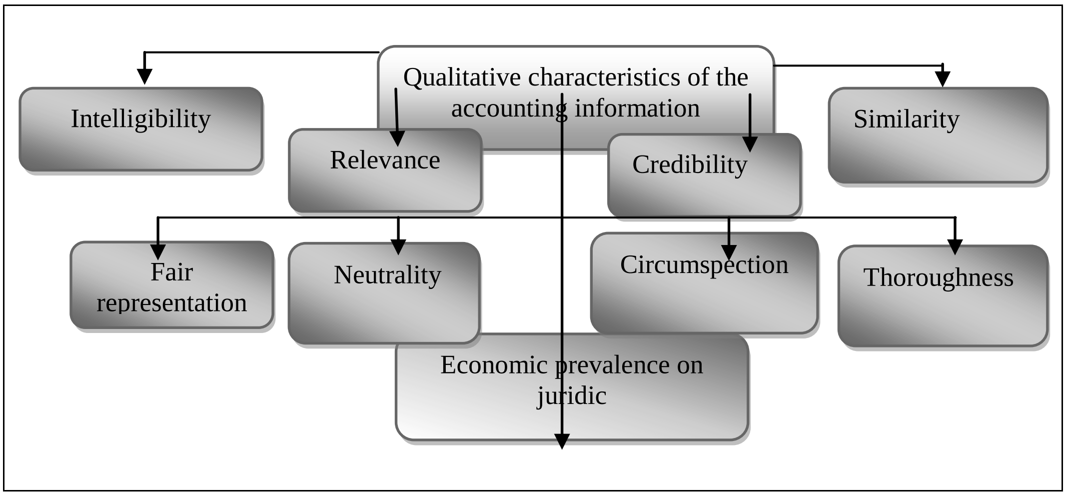

Figure 1. Qualitative characteristics of accounting information according to the Conceptual framework for accounting

Since 2002, the IASB and FASB have signed an agreement bearing the name Norwalk Agreement whereby the rapid increase of its forces to solve the problems of accounting treatments for searching solutions of the highest quality. General accounting framework has undergone improvement in year 2005, eight stages in the process of obtaining the final draft, a process whose final being established for the year 2010. In terms of the qualities that accounting information must meet to demonstrate its usefulness to investors and creditors, two groups are suggested: fundamental and amplifier characteristics, shown in Figure 2.

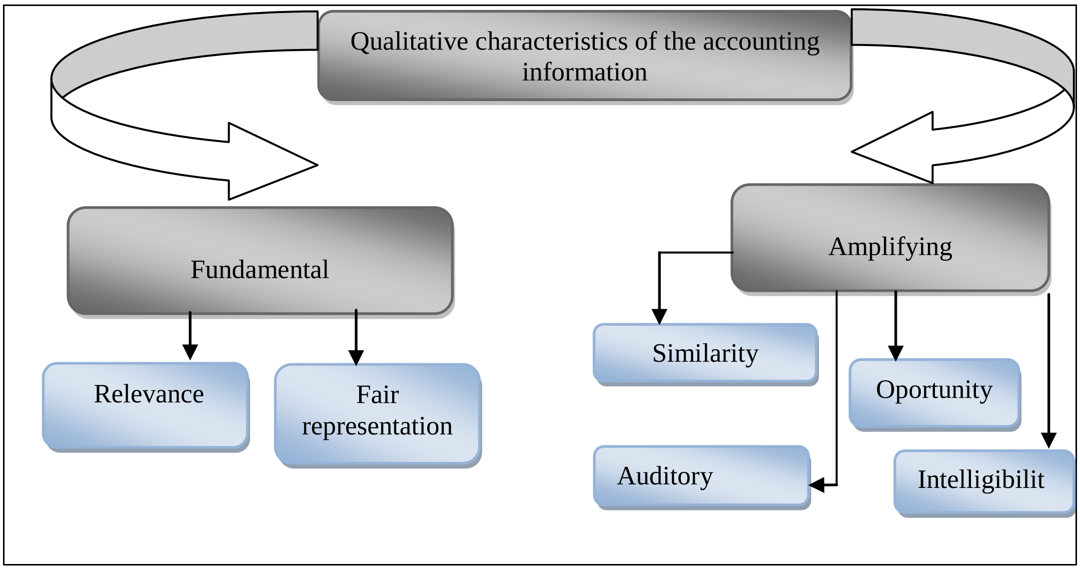

Figure 2. Qualitative characteristics of accounting information in accordance with the financial reporting framework

To be useful the information must be relevant and represent accurately what they want to represent. Characteristics belonging to the second category can amplify the usefulness of "*help*" in the choice of two alternative ways to be used to describe a phenomenon, if it is considered that both are equally relevant and accurate. Relevance and fair representation are features that need to be met simultaneously.

Information is irrelevant, but faithful represented as devoid of utility as a relevant information but not-fair represented. Giving up credibility is one of the qualitative characteristics of information. Fair representation is considered to be in the old version of the conceptual framework a characteristic of credibility, along with neutrality, economic prudence, relevance over the judiciary and integrity. The opportunity conditioned in the past the relevance and credibility of the information.

Currently, the opportunity is one of the features that amplify the usefulness of the information. A new concept in the context of why somebody verifiability is updated assumes that two different independent users, can reach a consensus on the correct representation of a particular description. As a result, donors are represented by investors, creditors (in particular banks), state and government agencies, landlords (under financial leasing contracts), etc.

In accordance with the regulation on international accounting, external users of information - as defined in the framework of processes and operations funding-are investors and creditors. It should not be overlooked that an economic entity with a financial solidity ensured a balance between political recourse to external sources of funding and generating own sources (the path of self-supporting through the various components depreciation of immobilized active and by spreading a rate of profit for formation of reserves).

Despite universal adoption of the fair value of the normalized accounting, the positive role of accounting in fair values has generated intense debate among investors, academics, normalizers. In order to assess the arguments for, and in favour of fair value it is required to understand the objectives of financial reporting.

5. THE OBJECTIVE OF FINANCIAL STATEMENTS

The financial statements shall present the financial results of an economic entity grouped by category of information in accordance with the economic characteristics of the generically "structures of financial statements" that are directly related to the evaluation of the financial position (assets, liabilities and equity) and performance (revenue and expenditure). Financial statements provide information concerning: *the financial position of the company; its performance; the cash flows*. This information become useful for various users in decisions relating to the justification to: the purchase or selling the participations in the company; the appointment or replacement of people from the governing bodies. The financial statements contain information on: active; passive; own funds; revenues, expenses, gains and losses; cash flows.

In table 1 we present a summary of the requirements for the preparation of the financial statements of an entity.

Table 1. The synthesis of requirements of financial statements by economic entities

Financial statements in accordance with the objectives of the EEC taking into account criteria of size Total assets: Eur 3650000 Net turnover: Eur 7.3 million Medium No. of employees: 50	Simplified Do not exceed the limits of two of the criteria of size
Balance sheet The profit and loss account The situation of the change on equity The cash-flow situation Explanatory notes	Abridged balance sheet The abbreviated profit and loss account Explanatory notes Optional: the situation of a change of equity and/or cash flow situation
Financial auditor report	Checking is done according to law

The objective of financial statements is to provide general information about: financial position; performance and cash flows of an economic entity, useful for a wide range of users in making economic decisions. The financial statements shall also forward the results of the management by the leadership of the enterprise resources entrusted to it.

Application of fair value in accounting seems to permit preparation of financial statements which make third parties better information regarding the performance of the present and future of the undertaking and therefore the possibility of their decisions. Such a statement forces us to ask ourselves the question on the relationship between the accounting results, in the broad sense of this term and the stock value of the company. The exponential growth of the financial markets, some foreign experts are asking the following question: *during past results and recognition is likely to generate information on the evolution of future results?*

The authors examine the direct link between the outcome and the course of the stock market and they enquire of the accounting assessments. Model Edwards-Bell-Ohlson provides an adequate framework for reflection, to the extent that the value of a company depends on its book value and abnormal results updated. Yet one question remaining: *why some firms negotiate prices higher (or lower) the accounting value?*

Despite the criticisms formulated, informing the financial information as a whole constitute the richest, made available to investors. The financial theory developments have eased the proposal of a framework to enable analysis of the importance of its contribution to the markets.

Annual accounts must give a true and fair view of the financial position, performance, modification of equity and of cash flows of the enterprise for that fiscal year. They must meet the needs of the users. However, experts in the field of accounting have found that they do not provide all the information they need in relation to decision-making, as "largely" the financial statements reveal the effects of past and does not provide, as a rule, non-financial information. Also, on the basis of the financial statements, the results of the evaluation of the management of the enterprise, including the management of the resources entrusted to managers. Those users who want to evaluate how management of the undertaking or to establish the responsibility of the manager take economic decisions aimed at either the option "*keep or sell*" in that undertaking, or reconfirming or replacing its leadership.

At the same time, financial statements constitute informational support required to carry out financial analysis oriented towards formulating a diagnosis. The different categories of users are using financial information and other information provided by the accounting, statistical and operational organisation, to diagnose its activities, and on that basis to substantiate economic and financial decisions. Each economic entity has an obligation to draw up annual financial statements which must include: balance sheet; the profit and loss account; the situation of equity changes; the situation of cash flows; accounting policies and explanatory notes.

The multitude of consequences for providing information via summary documents (the distribution of wealth among individuals, the aggregate level of risk and its allocation among individuals, allocating resources between companies, the level of the resources used for the production, certification, public disclosure, analysis and interpretation of information, etc.) generates the necessity of choosing the pattern of synthesis documents.

On the constituents of an optimal set of synthesis documents there is an agreement, and it was accepted only in regard to the fact that the policy for disclosure of synthesis documents is the result of the combined action of accounting normalisation and factors such as: the size of enterprise, the number of shareholders, the stock exchange listing, the performance of the undertaking, the costs associated with the disclosure of information.

We believe that the action of these factors, dependent on the characteristics of the economic, political, legal and cultural environment influences the decisions of managers drawing up and publication of documents.

As a result, between financial statements prepared in different countries there may be significant differences, not just targeting form and content, but also the objectives assigned to them.

To fulfil adequately their objectives, the synthesis documents should be well structured, readable, creative and concise, because only in this way will be able to play an important role in the decision-making process of the different groups: their financial analyst will try to forecast profits, the investor will want to choose a placement, the banker will study a request for a loan etc.

Accordingly, we can appreciate that the most direct relationship between accounting and enterprise management, regardless of the legal form of organization is the quality of accounting (via synthesis papers) of accurate, homogeneous, verifiable and pertinent information provider, in order to enable effective and operative decisions, tomorrow's accountants and users to better understand the relationships that exist between accounting and other disciplines, their area of responsibility, as well as the need for continuous improvement.

Based on the information contained in the financial statements, the economic decisions are made regarding: buying, keeping or selling a part of the capital; checking drivers accounts or management; estimate the capacity of the company to employees through salary or remuneration derived by offering other advantages; determination the tax policy, determining benefits and dividends.

The elaboration of such analysis serves both the management of the undertaking acknowledging actually reflected by the level of economic and financial performance and exercise control on this basis for realization of tasks scheduled and substantiation activity to come. The objectives of the annual financial statements are different from country to country, outlining the importance accorded to the different categories of users, i.e. external or internal users (those who are producers of the annual financial statements, owning an asset compared to external users).

6. CHARACTERISTICS OF PEER ASSESSMENT: HISTORICAL VERSUS COST FAIR VALUE

The transition from a system based on historical cost accounting, from one based on fair values was recognized as a conceptual revolution in accounting. It is considered by some specialists that historical cost would provide a significantly lower degree of comparability and relevance of information, being obviously rejected by users of such information, particularly by financial investors while accounting based on the fair value reflecting market values in financial statements and amendments thereto in the consolidated situations of the obtained results by economic entities.

Thus, in table 2 we present some characteristics of historical cost and fair value.

Table 2. Characteristics of the historical cost versus the fair value

Characteristics of the historical cost	Characteristics of the fair value
is the cost of origin - recorded, measured and evaluated upon entry of assets and debts; - in the case of assets, the historical cost consists in the cash sum paid or payable at the time of purchase or production that makes possible the acquisition of an asset; - in the case of debts, the historical cost equivalents represent the value obtained in exchange for the obligation or, in certain circumstances (such as corporation tax), the value of which is expected to be paid in cash or cash equivalents in order to off debts; - somebody verifiability and objectivity of accounting documents attesting to (the use of historical cost as the basis of measurement, enables manufacturers to provide financial statements, objective and verifiable information). - is the consequence of the application of accounting principles used in the Western practice, namely nominalism and monetary prudence (in order to be able to rely on the information provided by the manufacturers, internal and external users must ensure that the information is accurate and it is based on facts); - once established, the historical cost remains fixed, so long as the property remains in the possession of economic entity; - can be defined as that “sacrifice which has been consented to bring the good in its entity at the date of entry”; - the historical cost used in measuring the fair value can be defined in terms of the undertaken sacrifices (engaged costs) plus the associated cost of wasted opportunities; - orients accounting of economic entity towards the past, whereas plays information about the value on the balance sheet structures at the date of	Through the notion of the fair value we follow “correcting the acquisition costs of assets with their market value (...) the work done by the permanent balance sheet items revaluation”. Accounting dictionaries define fair value as a rational and fair estimate of the market price of a good, service or financial asset by taking into account elements such as: production/distribution costs, the utility (in the case of goods and services), yield (for assets) or market availability. In the field of finance, there are two streams of opinion with regard to the relationship between market value and fair value: - efficient markets theory, according to which on a well-organized and informed market, the market price is equal or almost equal to fair value, investors having immediate and adequate response to any external information; - behavioural theory, according to which, on the contrary, the market price is often very different from the fair value as a result of the collective spirit and emotional state of investors. The controversy between the two models (historical cost and fair value) had as its starting point the relevance of information based on market prices, but the period of time (moment) which belong to the prices used in the accounting evaluation and this is because, while historical cost uses market prices from the moment of obtaining the asset or debt, the fair value recourses to the current one. The fair value is based, firstly, on the prices available on the market, because they reflect the market’s assessment regarding: - the present value of future cash flows statements embedded in a single element (calculated through the current rates of interest); - the risk that the amount or timeliness of these flows will differ compared to expectations. This results in increasing the objectivity of having the effect of improving the value of the financial statements prepared informative of the economic entity. We can thus affirm that, in practice, the fair value is materialized in the market value or in values derived from it. We

their acquisition; - accounting professionals agree that the objective of the accounting should not be confined to play financial position and past performance of the economic entity, and for investors, a particular importance is presenting its prospects.	consider that the assessment at the fair value which deals with a large number of non-financial assets and liabilities can be the foundation of a new model of representation of economic entity by means of which it seeks better manifestation of uncertain financial states affecting financial forecasts of financial flows and investment opportunities.

7. CONCLUSIONS

The current model of financial reporting represents a mix between historical cost and fair values. Historical cost with all the inherent advantages set forth limitations, we can say that it has aged. Historical cost reflects fair value items at the time of their initial recognition as fair value at that date. But as time passed, he takes a very historic dash if the item still appears in the balance sheet.

Economic parameters, both general (purchasing power, interest rate) and specific (profitability) that surrounds it, never ceases to evolve.

Thus, in the case of a perennial in existence, historical cost accounts of an item may no longer play after a certain period, the exact value it should reflect. Of course, there are a number of corrections of amounts, as well as the revaluation of accounts, indexed to inflation, but these are insufficient for rendering an image closely. And the reason is that historical cost is less and less used in the valuation of the balance sheet in accordance with IFRS. That does not mean it will be abandoned, but only that it should be substituted where it does not work, with a different value. Valuation at fair value has many opponents in whose opinion the historical cost is still the most logical basis of measurement the financial statements presentation.

At the heart of the debate on historical cost in relation to fair value lies between compromising the credibility and relevance of the two associated forms of evaluation. At the level of individual societies, the historical cost will subsist and due to the fact that it is and will be required for the purpose of determining the taxable base by tax regulations.

Although the fair value is used in the assessment of the majority of items on the balance sheet, however, historical cost retains a well-defined status. The argument lies in the fact that, on the one hand, stocks and fixed assets held for sale cannot be assessed at a higher value than their cost, and on the other hand, for intangible asset headings, the tangible assets and asset headings exploration, for which there are accounts option on the assessment at historical cost or fair value, the basic treatment recommended by the IASB is the valuation at cost. Only in the case of real estate investment, IASB recommends as basic treatment: the evaluation at fair value.

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