APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS. EQUITY CONSIDERATIONS

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Abstract: *The analysis of equity information submitted by entities in the annual financial statements allows information users to assess the objectives and policies adopted by entities on capital management. Equity information is presented in the Statement of Financial Position, the Statement of Change in Equity and the notes accompanying the financial statements. While matters relating to the recognition, valuation and presentation of assets and liabilities in annual financial statements are subject to specific accounting standards, equity issues are not subject to a specific standard, which are dealt with in the General Conceptual Framework and in some accounting standards. The General Conceptual Framework defined the concept of capital and the maintenance of financial capital, and in IAS 32"Financial instruments: presentation", IAS 29"Financial reporting in hyperinflationary economies", IAS 1"Presentation of financial statements" and other standards are prescribed criteria for the recognition, valuation and presentation of equity items. Some equity items such as equity and repurchased reserves, own shares are subject to national legal regulations. Information on the existence of reserves recognised under the legal provisions or restrictions on the distribution of equity items to owners is of interest to users. After Romania's accession to the EU, there was an extensive process of modernisation of legislation covering both company law and accounting rules in terms of eliminating any legal provisions that would have limited the functioning of companies in a competitive environment. Entities whose securities are traded on a regulated market and some entities with full or majority state capital apply the International Financial Reporting Standards as an accounting basis. With some exceptions, the transition of these entities to International Financial Reporting Standards has not significantly affected the total equity highlighted under accounting rules in line with European directives. The main changes in the equity structure were determined by the adjustment to inflation according to IAS 29"Financial reporting in hyperinflationary economies" and adjustments made as a result of the first application of the International Financial Reporting Standards. The interpretation of the equity information presented in the financial statements should be carried out in the context of the provisions of the relevant accounting standards and national legislation.*

Keywords: *equity, financial concept of capital, reserves, equity adjustments, compound financial instruments.*
JEL Clasification: *M41.*

1. Equity information and its users

To make decisions on how to invest resources, existing and potential investors need both information that confirms or alters the results of previous assessments/estimates and predictive financial information that can be used for future actions.

Users of the information in the annual financial statements are investors, banking institutions and other financial entities providing borrowed resources, other creditors, entity staff, state institutions and other entities that may be customers or suppliers. Information provided by legal entities of public interest defined under the Accounting Act (art. 34 para. (2) of the Accounting Law no. 82/1991, republished, as subsequently amended and supplemented) is of interest to users of information due to the significant volume of assets and liabilities managed, the number of employees and the areas in which they operate.

The General Conceptual Framework states that various users "need information on the entity's resources, entity claims and other information on how efficiently and effectively the board of directors and management of the entity have fulfilled their responsibilities for the use of the entity's resources" (General Conceptual Framework OB 4). Among those responsibilities is that relating to the assurance of "certainty that the entity complies with applicable laws, regulations and contractual provisions" 9 General Conceptual Framework OB 4).

Information users shall have at their disposal periodic financial reports (interim financial reports) the minimum content of which is provided for by IAS 34 and the annual financial statements published in accordance with IAS 1.

2. Items presented in the Statement of Financial Position

Entities shall provide information on assets, liabilities and equity in the Statement of Financial Position in an intelligible manner and maintain their presentation from one period to the next.

Assets are resources from which entities expect to obtain economic benefits in various forms (income, earnings, cost reductions or other non-quantifiable cash benefits).

Debts are current obligations of entities (at the time of the financial statements) whose settlement will generate outflow of resources, either in the form of cash or in the form of other assets.

The presentation of assets and liabilities shall be carried out structured, either according to their liquidity (usually in the case of financial institutions) or according to their classification as fixed/current assets, i.e. short- or long-term liabilities.

Information on assets and liabilities enable users to „identify the strengths and financial vulnerabilities of reporting entities" (General Conceptual Framework ob. 13), assess their liquidity and solvency and identify potential resource requirements.

As defined in the General Conceptual Framework, equity is „residual interest in an entity's assets after deduction of all its liabilities" (General Conceptual Framework para. 4.4 lit. c). Equity information is usually presented in a synthetic manner in the Statement of Financial Position, other information being presented in the Statement of Change in Equity and in the notes to the financial statements.

Recognition and evaluation of the items presented in the annual financial statements shall be carried out in accordance with accounting policies in accordance with the relevant accounting standards and, failing that, in accordance with the professional reasoning exercised by using the documentation sources provided for in IAS 8 (IAS 8 para.11).

Recognition, valuation and presentation of different assets, in kind in the Statement of Financial Position shall be carried out in accordance with the relevant accounting standards, of which IAS 16, IAS 38, IFRS 16, IAS 2.

For their part, the aspects relating to the recognition, classification and presentation of liabilities in the Statement of Financial Position are treated in specific accounting standards, such as i.e. IAS 19, IAS 37, IAS 12, IFRS 9.

Unlike assets and liabilities, equity items are not subject to a specific accounting standard, with provisions relating to their valuation and presentation being contained in both the General Conceptual Framework and some accounting standards (e.g. IAS 1, IAS 29, IAS 32). Some equity items show the result of the entity's activity (profit or loss), while other items are the result of transactions carried out by entities in different situations such as, for example, retroactive reprocessing of accounting policies or correction of errors under IAS 8.

Since equity or net assets represent the difference between the value of the assets and liabilities of entities, the valuation bases adopted by the entities to assess these items may influence both the value and structure of the equity items presented in the Statement of Financial Position. In this respect we mention some of the evaluation bases that can be used by entities:

- cost valuation or revaluation of tangible assets in accordance with IAS 16;
- cost valuation or fair value valuation by profit and loss account of real estate investments in accordance with IAS 40;
- valuation at amortized cost, by other comprehensive income or by profit and loss

account of financial assets under IFRS 9.

3. Presentation of equity items in Statement of Financial Position

IAS 1 states that „an entity shall present separately each significant class of similar elements” (IAS 1 par 29). Items which are different in nature or function must be presented differently, unless they are insignificant.

Equity may be presented in the Structured Financial Position Statement, according to various criteria, such as the origin of resources (shareholder contributions), the result of the period and the result carried forward, the revaluation reserves and other reserves.

The holding of reserves serves both the purpose of capital adjustment and the role of protecting an entity’s creditors from potential losses. The companies Act (Company Law No 31/1990, republished, as amended and supplemented) requires entities to take part in the net profit for the purpose of constituting a reserve which can only be used by the entity under the conditions laid down by law.

With regard to the recognition of reserves, the General Conceptual Framework States that transfers to reserves „are allocations of retained earnings rather than expenses” (General Conceptual Framework 4.21).

Specific to the Romanian economy is that the legislation regulating some strategically important activities, such as the transport of electricity, in previous periods, natural gas and oil have included explicit provisions for the establishment of reserves for the development of transport infrastructure by highlighting them on account of expenditure accounts. By this way of highlighting the reserves, the state institutions sought to build up resources for infrastructure development and to reduce the tax base for entities active in the fields mentioned. In other cases, entities benefited from different tax concessions under the conditions laid down by the law, for example investing the profit in the acquisition of fixed assets or building new production capacity in some economically less developed areas.

The existence of reserves recognized under specific regulations (laws, government decisions) or capital items whose distribution to owners is restricted is relevant information to be disclosed in the notes to the annual financial statements.

At the same time, the existence of different rights of shareholders to receive dividends or to repay equity is essential elements in the decision-making process of potential investors.

4. The concept of capital and capital retention

Within the General Conceptual Framework, two concepts of capital are presented, namely the financial concept and the physical concept. The financial concept of capital is that adopted by entities when preparing and presenting annual financial statements and according to it „capital is synonymous with the entity’s net assets or equity” (General Conceptual Framework 4.57).

The physical concept of capital may be the basis for the preparation of financial statements where users of information are concerned about maintaining an entity’s production capacity, with the statement that „certain difficulties in assessing and implementing the concept may arise” (General Conceptual Framework 4.58).

The concept of maintaining financial capital in turn generates the concept of maintaining financial capital (General Conceptual Framework 4.59 lit a), according to which there is a close link between capital and how an entity's profit is defined. Profit can be defined as "the residual value remaining after expenses (including capital maintenance adjustments, where applicable) have been deducted from income" (General Conceptual Framework 4.60). According to the concept of capital maintenance, "profit is obtained only if the financial (or monetary) value of the net assets at the end of the period is greater than the financial (or monetary) value of the net assets at the beginning of the period" (General Conceptual Framework 4.59 lit a). Therefore, an entity is considered to have made a profit (return on capital) if the inflows of assets in a financial year were in excess of those required to maintain it.

Company law contains a provision that can be associated with the concept of capital maintenance. Thus, at art. 69 stipulates that "if there is a loss of net assets, the subscribed share capital will have to be replenished or reduced before any distribution or distribution of profit can be made". The mentioned law does not provide additional clarifications but, for the proper understanding and application, its provisions must be corroborated with the accounting norms applicable to the entities and with other legal provisions. Typically, an entity that reports a loss of net assets also reports a loss in the income statement. However, there are situations in which an entity reports an accounting profit in the event of a reduction in net assets. Such situations may arise as a result of operations which, although of an expenditure nature, are highlighted on account of reserves or other elements of the overall result. These operations include:

• highlighting the reduction in the value of property, plant and equipment on account of the revaluation reserve account;

• highlighting the reduction in the value of financial assets due to other elements of the overall result, such as the carried forward result or the valuation reserve at fair value (account 1038 "Differences in changing the fair value of financial assets available for sale and other equity items" OMFP No. 2844/2016);

• retroactive restatement of errors related to previous periods due to the carried forward result.

As a rule, the reduction in the value of some assets is recognized in the profit and loss account. However, according to the accounting policies adopted, discounts can be treated as an adjustment for capital retention and are not included in the profit and loss account according to relevant standards (IAS 16, IFRS 9, IAS 8).,

5. Recognition of equity items

In the accounting of the entities, the elements of own capitals can be represented by the share capital, consisting in the contribution of the owners the reserves provided by law, the revaluation reserves, other reserves, capital premiums, profit and the carried forward result. Unlike the assets and liabilities whose management is the attribute of the management of the entity, in the case of equity elements the legal component is essential, the decisions regarding these elements being left to the capital holders.

In Romania, the issues related to the share capital, the legal reserve, the revaluation reserve and other reserves constituted by companies, the redemption of own shares and other capital operations are regulated by Law no. 31/1990 on companies.

Regarding the recognition and measurement of equity elements in accounting, we can appreciate that due to legal and accounting regulations this process is standardized and does not present practical difficulties. However, there may be rare cases in which the staff of entities must exercise professional judgment in order to assess the extent to which a contract or financial instrument may generate an item of debt and / or an item of equity. For such cases, IAS 32 sets out "principles for presenting financial instruments as debt or equity and for offsetting financial assets and financial liabilities".

With respect to the classification of a financial instrument, IAS 32 requires that a financial instrument that creates a financial liability for the entity and at the same time entitles the holder of the instrument to convert it into an equity instrument must be classified on its components. Such financial instruments should be classified, at initial recognition, "as a financial liability, financial asset or equity instrument, in accordance with the contractual commitment fund and the definitions of the financial liability, financial asset and equity instrument" (IAS 32 para 15). For example, a loan agreement that entitles the creditor to convert its receivable into a fixed number of ordinary shares of the borrowed entity is a compound financial instrument. For the borrowing entity, the contract includes both a financial debt component and a loan-to-equity conversion instrument.

Other provisions of IAS 32 that are covered by IFRS-compliant accounting regulations and in the accounting regulations compliant with the European directives issued by the Ministry of Finance refer to the presentation in the annual financial statements of the repurchased equity instruments.

Entities may repurchase their own equity instruments under certain conditions provided by the Companies Law. IAS 32 provides that repurchased equity instruments "shall be deducted from equity" (IAS 32 para 33) in the statement of financial position. At the same time, the results of operations (gains or losses) determined by the purchase, sale or cancellation of repurchased treasury shares as well as the equivalent value received or paid for them are recognized directly in equity.

Depending on the nature of the assets and accounting policies adopted, entities may disclose in the Statement of Financial Position and other items of equity, for example in accordance with IFRS 2 and IFRS 9. In accordance with IFRS 2, in the case of goods or services acquired in a transaction with share-based payment, the entity "shall recognize an appropriate increase in equity if the goods or services have been received in a share-based payment transaction settled in equity instruments, or a liability if the goods or services have were acquired in a cash-settled share-based payment transaction" (IAS 2 para 7). To highlight the elements of equity according to IFRS 2, in the Chart of Accounts approved by the accounting regulations approved by O.M.F.P. no. 2844/2016 provides for account 1038 "Other equity elements" / analytically distinct.

According to IFRS 9, depending on the business model and cash flows generated by assets under management, entities may adopt as an accounting policy the classification of financial assets as subsequently measured at either amortized cost or fair value through other comprehensive income or fair by profit and loss.

To highlight the differences resulting from the valuation of financial assets through other elements of the overall result, in the chart of accounts approved by the O.M.F.P. no. 2844/2016 provides for account 1035 "Differences from the change in the fair value of financial assets valued at fair value through other elements of the overall result".

6. Equity adjustments due to the transition to IFRS

The application of IFRS as an accounting basis was made based on legal provisions issued by the Ministry of Finance, the National Bank of Romania and the Financial Supervisory Authority.

Economic operators have made the transition to IFRS in two stages, as follows:

• the entities whose securities were traded on December 31, 2012 on a regulated market have prepared the financial statements in accordance with IFRS starting with this date;

• other entities with full or majority state capital have applied IFRS starting with the financial year 2018, given that they have applied extra-accounting IFRS for the financial years 2016 and 2017.

Depending on the structure of the assets, liabilities and equity existing in their accounting, the entities made the adjustments required by IFRS at the transition date.

In order to highlight the changes in the value and structure of equity caused by the transition from accounting regulations in accordance with European directives to accounting regulations in accordance with IFRS, the information presented in the first financial statements published by entities required by law to apply these standards was analyzed.

The database used in the analysis was represented by the annual financial statements published by these categories of entities on their websites (the annual financial statements published by 30 entities whose securities were traded on a regulated market and the annual financial statements published by 13 entities with full or majority state capital).

The research aimed to highlight how the transition to the application of IFRS by the categories of entities mentioned affected the elements of assets, liabilities and equity highlighted in their accounting according to the accounting regulations compliant with European directives.

Regarding the assets of the entities, the conclusions of this study were published in Contemporary Economy Journal, Vol. 2, Nr. 3/2017.

Unlike the presentation of equity elements provided by the accounting regulations compliant with European directives (Minister of Finance no. 3055 / 2009) where each item of a different nature is presented separately, in a predetermined format, the presentation according to IFRS is usually condensed by combining the different elements of equity. In these conditions, it was difficult to perform a comparative analysis between the values of the different equity elements presented according to the two accounting regulations.

The analysis of the information presented by the entities that were the subject of the study highlighted the following aspects:

a) the entities adjusted their share capital and reserves to inflation according to IAS 29. Whereas a large part of the analyzed entities were legally constituted in periods prior to 2003 (until which the Romanian economy faced a hyperinflationary process), it was necessary to update the equity elements to inflation.

The result of the inflation update was recognized in a separate carry-forward account provided for in the accounting regulations (account 118 "Deferred income from the first-time adoption of IAS 29"). This inflation adjustment operation of equity items (non-monetary) did not affect the total value of equity presented in the annual financial statements, but only their structure. As a result of the inflation adjustment, a legal share capital plus an adjustment to inflation and a negative carry-forward result of equal value to the adjustment of the share capital are presented in the own capitals.

b) the revaluation reserve has, in some cases, been reclassified according to the accounting policies adopted by the entities.

IFRS 1 allows entities to make use of exceptions and exceptions to the provisions of certain standards when they first apply IFRS. Thus, some entities (for example OMV Petrom SA, Rompetrol Rafinare SA, Compania Națională de Transport de Energiei Electrice Transelectrica SA) have adopted as an accounting policy the valuation at fixed cost of fixed assets when switching to IFRS and have abandoned the revaluation policy of them. The adoption of this accounting policy resulted in the modification of the equity structure in the sense of derecognition of the revaluation reserve at the same time as the recognition of a positive deferred result.

c) the application of IFRS for the first time involved the recognition of assets and liabilities that met the criteria set out in the accounting standards and the derecognition of other items. Due to the highlighting in the equity accounts of some reserves for which the tax legislation provides for taxation under certain conditions, there were frequent situations in which the entities recognized deferred tax related to these reserves on account of a separate account (account 1034 "Current income tax and income tax deferred profit recognized on account of equity ").

Among the items that were subject to derecognition at the transition to IFRS are the tax provisions recognized in accordance with the accounting regulations compliant with European directives.

d) IFRS 1 requires that adjustments made to the transition to IFRS are generally accounted for in the retained earnings. As a result of recognizing liabilities or adjustments to the value of assets, some entities recorded a negative carry-forward result, which meant a reduction in equity.

The research showed that although there were changes in the structure of equity, the general trend was to maintain their value according to IFRS compared to the values highlighted according to accounting regulations compliant with European directives. Thus, most entities presented variants of the value of equity less than 10% (example Biofarm SA, Oil Terminal SA, Zentiva SA, Aerostar SA, National Electricity Transmission Company Transelectrica SA, Romatsa SA, National Salt Company "SALROM" SA). Other entities showed significant reductions or increases in equity according to IFRS, for example the Romanian National Post Company registered a reduction of 32% while the Autonomous Administration "Romanian Auto Registry" showed an increase of 19%.Un element de analiză care oferă informații relevante pentru utilizatori este reprezentat de „rezultatul reportat".

The carried forward result derives from transactions, different in nature, that the entities carry out so that in case of significant values the synthetic information presented in the Statement of financial position must be detailed in the notes to the annual financial statements.

Among the operations leading to the recognition of a deferred result are:

- the recording of retained / unrecovered profit or loss in previous financial years;
- the correction of errors related to previous financial years or the retroactive modification of accounting policies;
- highlighting the results of the restatement performed at the transition to IFRS (highlighting some adjustments to the value of assets, provisions);
- highlighting the carried forward result representing the revaluation surplus realized, according to IAS 16;
- highlighting the result carried forward when applying IFRS for the first time following the adoption of fair value as an assumed cost.

IFRS-compliant accounting regulations provide for grade II synthetic accounts to record each transaction in the carried-forward income statement, depending on its nature.

7. Conclusions

According to IAS 1, entities must disclose in their annual financial statements information about their assets, liabilities and capital so that users of the information can appreciate how they have been managed.

Entities use the financial concept of capital in preparing their annual financial statements and according to this concept, capital is synonymous with net assets or equity.

The use of different valuation bases for assets and liabilities can influence both the value of equity and the structure of the items presented in the annual financial statements.

With some exceptions, the transition to IFRS-led accounting by statutory entities did not significantly affect the amount of equity highlighted under accounting standards in line with European directives. This situation can be explained on the one hand by the fact that the provisions in the accounting rules compliant with European directives have been gradually aligned with the provisions of IFRS, and on the other hand by the fact that those entities did not have financial instruments that are classified accordingly. IAS 32 as financial liabilities and equity instruments.

Equity items that have changed at the first date of application of IFRS have been carried forward, highlighting the adjustments caused by the first time application of IFRS and share capital and reserves that have been adjusted for inflation in accordance with IAS 29 to most entities.

The information presented by entities shall "enable users of the annual financial statements to evaluate the objectives, policies and processes of the capital management entity" (IAS 1 para. 124A).

In order to carry out this assessment, information users must have both general knowledge of the concepts and provisions of the relevant accounting standards and knowledge of the legislation applicable to the entity under review.

Company law, accounting law (Accounting law no. 82/1991, republished, with subsequent amendments and completions) and accounting regulations approved by O.M.F.P. no. 2844/2016 have been amended and supplemented successively so that the provisions contained therein do not limit the proper application of IFRS.

References:

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