THE ROLE OF ACCOUNTING AND FISCAL POLICIES IN THE RELATIONS BETWEEN ACCOUNTING AND FISCALITY

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Abstract. The need to compile and approve the accounting policies in applying the accounting regulations is provided by the Order no. 3055/2009 for the approval of the accounting regulations consistent with European directives and applicable from January 1st, 2010. These policies should be developed considering the nature of the activity and should be developed by specialists from the economic and technical field who are familiar with the activity carried out and the strategy adopted by the entity and approved by the administrators of the economic entity. When choosing the accounting policies, one must consider the objective of the financial situations, namely to present the precise image of the financial position of the outcome as well as the modification of an entity’s financial position. Fiscal rules should not have any role in decisions on accounting policies adopted by the economic entity. Unfortunately, the accounting specialists still remain victims of the habit of thinking the economic transactions in terms of fiscality. There is an artificial dependence of fiscal accounting, maintained by the practice.

Keywords: evaluation, recognition, accounting policies, fiscal policies.

1. Preamble

Accounting regulations applicable in Romania define the accounting policies as the specific principles, bases, agreements, rules and procedures adopted by the entity in the preparation and presentation of the annual financial statements, the definition being quoted from IAS 8 Policies, Changes in Accounting Estimates and Errors.

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1 The paper was developed within the doctoral research for the thesis "Harmonization on the accounting-fiscality report in Romania", institute of Doctoral Studies, ASE, Bucharest
2 Order of the Ministry of Public Finances no. 3055/2009, Accounting regulations conformant with the European Directives
Fiscal policies represent a set of decisions, choices and actions at company level with the objective to achieve an optimal fiscal cost to match the company’s aspirations.

Following the specifications made by OMFP 3055/2009 Accounting regulations conformant with the European Directives, on the requirement that all economic entities must develop a set of accounting policies, many materials on this topic have been published in literature. Throughout this paper we shall refer to them.

2. The role of accounting and fiscal policies in the relations between accounting and fiscality

The differences between accounting and fiscal policies arise in integrated relations (engaged), being determined by the intersection between accounting and fiscal interest. The main element which is considering the reconciliation of the relationship between accounting and fiscality is the taxation of profit as a direct or indirect result of the recognition, assessment and depreciation, this also being the field we shall refer to when analyzing the accounting and fiscal policies.

The objective of accounting policies should be the presentation of an accurate image of the economic entity and the purpose of fiscality the taxation of profit. The accurate image can not be quantified or measured exactly, which makes many of the accounting professionals to comply with fiscal rules first, choosing accounting policies consistent with fiscal rules. This maintains the subordination relationship of accounting to fiscality, although accounting rules should guide us towards independence between the two of them. In theory this barrier of dependence of accounting to fiscality has been overlooked, which, most often does not happen in practice.

3. Accounting policies

The conduct of business operations is administrated and controlled through accounting policies and the basis for determining the information needed for the internal and external users in order for them to underlie the decisions is established.

The International Accounting Standards states that, in certain cases, different treatments are allowed for certain transactions and events. Usually, a treatment is known as "benchmark treatment" and the other as "permitted alternative treatment". The financial statements of an entity can be described as prepared in accordance with the IFRS’s provisions no matter what treatment was used: the benchmark treatment or the permitted alternative treatment. However, "because
different methods lead to different results, on several occasions IASB has acknowledged the need to reduce the possibility of using permitted alternative treatments to provide a truly real harmonization. In this respect, standards are necessary in order to bring more uniformity into the accounting reports prepared.\(^3\)

Although the IFRS had a significant role in the development of accounting in Romania, the objective of this paper is the presentation of accounting policies in terms of national accounting regulations because "in the relationship with the state, all entities, including those applying IFRS standards, prepare annual financial statements that are in accordance with the European accounting directives."\(^4\).

Within the national accounting regulations, the accounting policies and procedures are based on both the accounting principles and the normative regulation system. The reference system for elaborating accounting policies accepts alternatives to register and assess in accounting, respectively various methods of assessment and calculation of the financial position, result and modification in the financial position.

We must point out that through the compulsoriness that all economic entities are required to develop a set of accounting policies, the drawing up of a “certificate” is envisaged, where the economic entity to record the accounting treatments, assessment methods, rules of recognition that it has adopted and must observant of, being able to modify them only under certain conditions.

Choosing an accounting policy, among those accepted, determining the volume and the type of information to be provided and the form in which this information should be presented requires establishing from the possible choices the one that generates the best information for decision-making. The best information must be consistent with the most accurate image of the financial position, performance or evolution of the financial position.

Emphasizing the conformity of the annual financial statements with the stipulations of the accounting referential in relation to their accurate image, M. Ristea\(^5\) highlights the fact the compliance with the provisions of the accounting regulations does not exclude the presence of some freedom.

The presence of several options in the accounting referential, namely wide varieties of accounting policies, as well as a variety of assessment techniques, can sometimes lead to serious consequences on the decision-making process. The option of the company management for one of the many treatments and accounting policies creates implicitly the possibility to deliberately choose the

\(^3\) M. Ristea and C. G. Dumitru in Caution and aggressiveness in accounting treatments, Tribuna Economica Publishing House, Bucharest, 2008, page 49


\(^5\) Mihai Ristea, Compliance and freedom in accounting policies to close the financial year, article published in Pro Domo, CECCAR Monthly Journal no. 2/2011, page 19-22
treatment or policy that meets the interests of the entity, which does not always converge to the accurate image but rather to a conventional one. Thus, V. Munteanu and M. Zuca\textsuperscript{6} believe that it is possible that a distortion of the quality of financial information to result from this, generating uncertainties in relation to the consistency and comparability of the information intended for users.

The process of choosing accounting policies has a special impact on the quality of information provided to all interested users so that the financial statements must contain information regarding the accounting policies adopted by the entity, through the explanatory notes to the financial statements.

The process of selection and implementation of the accounting policies must be done consistently for transactions, other events and similar conditions, unless an accounting rule specifically requires or permits categorisation of items for which different policies may be appropriate.

The authors of the paper entitled \textit{Accounting policies as amended by the accounting regulations in accordance with the EEC fourth Directive}\textsuperscript{7} consider that "when selecting the accounting policies one should take into account the economic context in which the entities operate, the strategy of the entity, namely whether the company pursues immediate large profits or its development through new investments in technology."

However, regardless of the economic context and the strategy of the entity, one must consider the need to ensure continuity and consistency of implementing the accounting policies for complying with the principle of consistency for accounting methods. This is necessary so that the financial statements to provide information necessary in decision-making that can be comparable over time, to identify trends in the financial position and the accurate performance of the entity.

The accounting policies can be modified as a result of changes in regulations or, very rarely, at the initiative of the entity, and this must be justified in the explanatory notes to the financial statements. The modification of the accounting policies at the initiative of an entity may be determined by an exceptional change occurred in the situation of the entity or in the economic and financial context in which it operates or when the implemented accounting policy leads to false or irrelevant information.

Regarding the modification of an accounting policy, IAS 8 \textit{Accounting Policies, Changes in Accounting Estimates and Errors} states that\textsuperscript{8} “when an entity changes an accounting policy upon initial application of an IFRS that does not

\textsuperscript{6} Victor Munteanu and Marilena Zuca, Considerations on the use of creative accounting in the deformation of information within the financial statements and “the maximization” of the company’s performance, article published in Audit financiar Magazine no. 3/2011, page 3-10

\textsuperscript{7} Georgeta Petre, Alexandra Lazar, Elena Iancu, Monica Avram, Elisabeta Duinea, Daniel Petre, Accounting policies as amended by the accounting regulations in accordance with the EEC fourth Directive, Monitorul Oficial Publishing House, Bucharest, 2010

\textsuperscript{8} IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, point 19 (2009 Edition)
include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.”

The retrospective application requires that the entity must adjust the opening balance of each affected asset component for the oldest period presented, and other comparative amounts disclosed for each prior period presented, as if the new method had been always applied.9

Accounting regulations applicable in Romania, have a different view on the effects of changing the accounting policies, they simplify the modification treatment, as follows10: “The modification of accounting policies is done only for the future period, starting with the financial year following the year when it was decided to modify the accounting policy.” But it narrows the statement by “the modification of accounting policies can be done only at the beginning of the financial year. Modifications of the accounting policies during a financial year are not allowed”.

Given the fact that the accounting policies and regulations provide several treatments to solve the same problems, some distortions inevitably emerge in relation to the relevance of accounting information, and / or differences between the obtained results. An economic entity chooses its accounting policies also based on its own interest, on that company's strategy. As a result, an economic entity can develop an aggressive behaviour pursuing immediate high profits, or a conservative behaviour (prudent), pursuing long-term growth through new investments. Therefore the results of an entity can be manipulated through the accounting policies.

For the purpose of the above, the following idea emerges: in support of maximizing profit, the entity will have an aggressive behaviour, which involves the selection of some accounting policies to include rules that lead to lower costs in the profit and loss account, unable to exert influence on revenue because they have strict rules for recognition in accounting, namely the recording of revenues can neither be advanced nor postponed.

Among the registering possibilities of some low costs in accounting, in relation to the national accounting regulation, are the following:

- inclusion of formation expenses to “Active”, where the company can lock up the formation expenses. Following this selection, the recovery will be done through depreciation and if the maximum depreciation period is chosen, then the expense will be reduced;
- establishing a large duration of economic life for tangible assets and therefore, their depreciation on a long period, resulting in an expense with reduced depreciation in the profit and loss account;
- choosing the linear depreciation method;

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9 Nicolae Feleaga and collective, Accounting policies and options, Infomega Publishing House, Bucharest, 2008
10 Accounting regulations in accordance to the European Directives, point 44, paragraph (2)
accepting some elements that should have been acknowledged as expenses of the period, as a component of fixed assets;

• accepting some elements that should have been acknowledged as inventory items materials, as a component of fixed assets;

• choosing the method First In-First Out for the calculation of stock costs which will ensure lower costs;

• capitalization of interest, namely the introduction in the value of the assets with long manufacturing cycle of the interest due for the period, for the loans contracted by the company to finance the acquisition or construction of long-term assets.

At the opposite pole, are the entities that have as strategy a conservative behaviour with the purpose to maintain the capital and who choose the following accounting policies:

• inclusion of formation expenses to expenses of the period in which they occurred;

• finding the optimal duration of use of tangible assets, by a technically rigorous correlation of the duration of the economic life during which depreciation is calculated, with the actual usage of tangible assets. The life duration used for fiscal purposes can be taken as a benchmark;

• choosing the assessment method Last In-First Out or the Average Weighted Cost method for calculating the stock costs. These methods lead to a more balanced cost;

• registering the expenses with the interests associated to the assets with long manufacturing cycle within the profit and loss account of that period;

• setting up clear technical criteria depending on which future costs made with tangible assets come under to expenses of the period or increase the value of the tangible assets;

• periodic revaluation of tangible assets leading to expenses for the higher depreciation.

“The way in which accounting policies are applied is based on the professional reason. In many cases, this professional reason leads to prejudicing the financial position and results”, an opinion expressed by V. Raileanu. Thus, there is the possibility that when choosing the accounting policies, the entity will show “creativity” abusively using some treatments or accounting policies, which leads inevitably to a “distortion” of the image of the entity’s heritage. Of the situations that can be used for this purpose, we mention the following:

11 V. Raileanu, C. L. Manea, C. Rapceanu, The intercommunity of the ethical professional accountants with the creative accounting practices, article published in Accountabiliti, expertise and financial audit Magazine, December 2009, page 64-68
• appreciation of the fact that there are no indications of depreciation of assets, thus avoiding registration expenses, or, on the contrary, resulting in depreciations higher than the real situation;
• the inclusion or non-inclusion of some costs within the acquisition or production cost;
• adopting an unaccountably optimistic attitude about the chances of success of a developing project will lead to their capitalization with consequences on the outcome.

As emerges from the above, the accounting policies affect the level of the outcome and there it should be a guarantee that the entity has not turned to accounting manipulations in order to increase profits. Such a state of things is improved for companies that are required to audit their annual financial statements.

4. Fiscal policies

At company level, fiscal policies represent the concrete manner in which specific instruments and techniques are used to achieve the objectives of fiscal management. If, for accounting purposes, the entities are subject to accounting rules in order to present an accurate image of the financial position, the outcome as well as the modification of the financial position, from the fiscal point of view, they are subject to fiscal rules existent in the moment of calculating income taxes and taxes.

Practically, fiscal policies have the following objectives:
• to ensure the fiscal security of the company, namely the compliance with the fiscal regulation of its field of activity;
• fiscal efficiency, namely paying and discounting of some taxable amounts as small in relation to the freedom of manoeuvre provided by fiscal regulations;
• to organize a fiscal management based on minimizing fiscal costs made according to the following structure:
  o the management cost for developing the information system and its operation for fiscal interest;
  o the actual financial cost consisting of the sum of fiscal expenditure regarding taxes, including income tax expenses;
  o the liquidity costs determined by the taxes settlement, costs of tax debts and costs on certain fixed terms of payment of taxes.

A proper example for this is the income tax. The calculation and payment of income tax, except for banks and a couple of financial institutions, are done quarterly, being cumulated from the beginning of the year. There are many situations where, after the cumulative calculation at the end of the financial year, a
fiscal loss results although the income tax was paid during the year. This situation involves liquidity costs for the accounting entity.

Accounting offers the possibility to choose certain treatments, methods and accounting options, while fiscality offers entities the possibility to choose or to implement certain optional provisions. Fiscality acknowledges some of the principles, methods and rules stipulated by the accounting regulations. Without covering the subject, we are referring to the principle of the permanence of methods, the principle of matching expenditures with revenues, stock assessment methods when leaving the inventory, etc. But there are situations where it is developing its own applicable methods and rules for the calculation of income tax, such as recognition and depreciation of tangible assets, the recognition of revenue and expenditure, providing stimulants or tax incentives, etc. Throughout the paper we shall largely refer to these differences between fiscal and accounting rules and methods.

The interest of an entity is to gain profit, but also to reduce the debt on income tax and the accounting specialist must build the outcome desired by the owners using in the most healthy way the fiscal incentives and the accounting and fiscal treatments (when he has a choice). In this respect, he will seek those fiscal policies that allow him to defer the fiscal duties.

The deferral of fiscal duties can be made through a set of fiscal policies of which:

- appropriate use of assessment methods when entering the patrimony;
- optimal use of depreciation regimes;
- evaluating the output of goods and values;
- game of provisions;
- treatment of costs that can be capitalised.

Of the possibilities of using fiscal treatments and methods so that the entity to obtain a minimization of income tax by its deferral, are the following:

- when assessing the entry into the patrimony, the company will act so that a large part of the expenses that may be found in the input value (acquisition cost or production cost) to be considered expenses of the period, thus gaining immediate and full deductibility;
- the fact that legal regulations allow the use of three depreciation regimens for fixed assets allows the company to choose between a faster or slower recovery of the amounts invested in fixed assets. From the fiscal point of view, the most favourable method is the depreciation method which defers the fiscal duty, namely the method which allows the faster recovery by depreciating the value of fixed assets. The degressive and accelerated depreciation method also help the objectives of fiscal management: in the first years, the depreciation expense is higher, so the fiscal profit and tax are lower, while in the
latter part of the allowed operation period, the depreciation is much smaller and the amount of payable tax is higher;

- the assessment when exiting the patrimony of the interchangeable elements (or fungible), as stocks and securities can be done in several ways. The fiscal interest recommends the method which allows the assessment at the highest price, namely LIFO or AWC. In terms of inflation, such an approach is better due to its financial implications;
- provisions which are formatted based on the probability of the emergence of loss, risk and depreciation represent a privileged instrument of fiscal policy when their fiscal deduction is allowed. The taxable outcome is reduced in formation without generating payments, and in cancellation or reduction, revenues that do not generate income are found.

5. Conclusions

In the purpose of the above, it can be said that the accounting policies are permissive and relative, and raise the issue of accounting objectivity and therefore the accurate image of the financial position, outcome and the modification of an entity’s financial position.

Practice shows that the accounting policy has an impact on the financial performance of an entity that acquires the desired image with the help of professional accountants endowed with “creativity grace” and encouraged and helped by deficiencies in accounting rules. Experts’ creativity can hide through deferral and attenuation, the bad news about the economic entity's financial performance, but not forever, because there are numerous ways of detecting them.

Manufacturers of “cosmeticised” information should take into account an important aspect - that, if they frequently resort to this method, they will be in a position to have irrelevant financial statements, based on which no decisions can be made and long term goals cannot be established and these reflect a hypothetical profitable economic entity, which in reality may be on the verge of bankruptcy. Managers that found themselves in such situation may take hasty decisions based on their illusory financial statements, which do not correspond to the real situation and may have the most unpleasant effects - in which case it remains to be seen who was really fooled.

As shown in the study of accounting and fiscal policies, but also the relation between accounting and fiscality, the elements that can generate differences between these two areas are the following: acknowledgement and measurement, depreciation and implicitly the taxation of profit.

In our opinion, although the difficult journey from the accounting’s dependence of fiscality to disconnection has been covered, there is still a difficult
and arduous road from theory to practice. Any difference between the accounting policies adopted by the company and the fiscal policies must be amended accounting-free. We must not let the fiscal policies influence us when choosing the accounting policies even though this would mean less work.

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