International Business Management 10 (23): 5663-5668, 2016
ISSN: 1993-5250

Revisiting the Fair Value and Historical Cost and Their Impact on the Financial Indicators of the Company

[1]T.Y. Serebryakova, [2]G.S. Klychova, [1]L.P. Fedorova and [1]O.G. Gordeyeva
[1]Cheboksarsky Cooperative Institute, Russian University of Cooperation, 428025 Cheboksary, Russia
[2]Institute of Management, Economics and Finance, Kazan Federal University, 420008 Kazan, Russia

Abstract: The Russian accounting practice is being improved on the basis of international standards of financial accounting. Nevertheless, not all conventions adopted by these standards allow the explicit and correct disclosure of a company financial standing data in the financial statement. It is connected with recognition and assessment of assets and liabilities. The primary recognition is based on the historical cost. The one following it on the fair value, the latter being not quite unprejudiced. There occurs a risk of financial accounting misstatements. As a result of the reassessment by the fair value, both the assets and the liabilities, including the equity capital are changed into the equivalent values. The conclusions in respect of the financial status are based on the financial standing indicators analysis which manifests that the company reporting made in compliance either with the IFRS or with the Russian standards enable to make similar conclusions on the financial standing of the company.

Key words: Historical, fair value, financial, standing, indicator

INTRODUCTION

The national accounting practice transition to the internationally acknowledged methods has become an accomplished fact upon the International Financial Reporting Standards (IFRS) introduction on the territory of our country. Meanwhile, not all accounting conventions characteristic of the IFRS are appreciated unambiguously as locally and in other countries of the world (Potekhina, 2014). The debates on the advantages and drawbacks of the accounting objects assessment either by the fair value or by the historical cost have started in the scientific publications after the financial recession of 2008. The topic of the discussion has been the impact on the reliability of financial indicators presented in the public companies reporting rendered by the assessment option selected by the company. It shows the ambiguous position held both by the practitioners and the researchers concerning this issue (Griffin, 2014). It is still open for discussion, since a number of the researchers have substantiated the manipulating opportunity with the financial instruments value which could aim at the more attractive presentation of the portfolios in the published annual reports of the financial companies (Chan, 2008). Let us, emphasize straight off that such substantiation and research is rather urgent particularly for the financial institutions due to the complexity and multi-variance of classification and assessment of financial assets for their information disclosure in the financial accounting. It should be considered that the recession of 2008 has started particularly in the area of the financial markets (Gil, 2004; Beutler, 2014).

Accounting of objects established by international standards for fair value assessment is applied in any economic entities; that is why its application necessity and relevance is so important for all companies (Aktas and Kargin, 2011). The assessment by fair value may be considered a tribute to a compromise forming the basis of the IFRS-this comment of the researchers may seem interesting in view of the European accounting community opinion being on the side of the historical cost indicator (Senge, 1999). We consider that financial companies are the most exposed to the risk of data misstatements in respect of the financial standing due to the largest ratio in the assets and liabilities of financial instruments which are primarily subject to assessment by the fair value. By virtue whereof the risk of manipulating with the their value estimation data is extremely high. Simultaneously we consider it urgent to study the

Corresponding Author: G.S. Klychova, Kazan State Agrarian University, 420015 Kazan, Russia

accounting misstatement risks while assets and liabilities assessment by applying the IFRS regulations in the companies of another activity fields. This particular issue will be considered in the present study.

MATERIALS AND METHODS

Without prejudice to the financial instruments, let us dwell on the information disclosure in compliance with the Russian Accounting Standards (RAS) regarding other assets of the company. The standards currently in force in Russia prescribe it to form the reported assets value in at the primary recognition by uniting all expenditures due to their procurement, construction, bringing to condition suitable for use. Such rules are applied to any assets purchased for fee as well as acquired by any other means. These assets can further change their value, though such changes are not always reflected in the financial statements (Needles *et al*., 2010, 2014). Firstly, the changes may be due to the real monetary expenditures, such as modernization, completing the construction or further equipping which may take place only in respect of the capital investments.

Such expenditures increase the primarily acknowledged assets value. Secondly, the company may carry out reassessment of the main funds due to the change of their current restoration value both upward and downward. Herewith, the difference that occurs shall be reflected on the whole as the equity capital but under certain conditions the revenues and expenditures of a reporting period may be considered as well (Filip *et al*., 2015).

This rule is applied only in respect of the objects belonging to the main funds. As for such assets as material and production stocks, financial investments which are not circulating on the free market, their value is regularly checked for the devaluation. It may be corrected only if the current market price is lower than the accounted one, decreasing it to the market price (Pedler and Berkon, 2001; Peltoniemi, 2011). Financial instruments traded at the markets are accounted in compliance with the RAS requirements and are reflected in the reports by the current market value. The occurring differences are charged to the gains and losses of the reporting period. The assessment in compliance with RAS rules of accounting objects are summed up in the Table 1. The cases of the value change for reporting by IFRS rules are represented in the Table 2.

Judging by the principles represented in Table 1 and 2 the companies make their reports for different purposes: for presentation to the state bodies in the RAS format, as well as in the IFRS format for presentation to the owners and in cases which may occur for business and state requirements. There are a lot of such companies at present.They transform Russian accounting into the accounting as per the IFRS requirements which enables to compare the indicators of the report on the financial standing (Klychova *et al*., 2014).

Table 1: Principles of assets and liabilities assessment for accounting and reporting by RAS

Name of the accounting object	Initial recognition principles in the accounting	Assessment change in accounting	Obligation and regularity	Accounting of difference	Principles of reflecting in the financial accounting
Main funds	Actual expenditures: procurement,bringing to the condition suitable to use	Bringing the value to the current restoration and respective correction of amortization	Optionally	For the capital at insufficiency for the financial result of the period	Depreciation value, judging from the restoration or the initially acknowledged
Intangible assets	Actual expenditures, due to the procurement, bringing to the condition suitable to use	By the current market value of the active market by correcting of the depreciated value; Check for devaluation by IAS 36, the lowest between the reimbursed and the balance (depreciated) value	Optionally; Mandatory, regular, once a year	For the capital at insufficiency for the financial result of the period; For the gains and losses of the period	Depreciation value (no revaluation)or the current market value; By the minor: Depreciation value/ reimbursed minus the corrected amortization
Financial investments	Actual expenditures due to the procurement	Check for devaluation by the financial investments not traded at the active market; By the current market value, by the financial investments traded at the active market	Mandatory, regular, once a year; Mandatory, regular, no less than once a quarter	For the gains and losses of the period;For the gains and losses of the period	By the minor:initially acknowledged /acknowledged minus the devaluation;By the current market value
Receivables	Actual value of the transaction	No	Mandatory, regular, once a year	For the losses of the period	Actual value of the transaction without the reserve by the doubtful debts
Financial liability	Actual value of the transaction	No	No	No	Actual value
Material and acknowledgement production reserves	Actual expenditures, due to the procurement	Check for devaluation	No less then once a year	losses of the period	For the gains and By initial minus the devaluation

Table 2:Assets and liabilities assessment principles for accounting and reporting by the IFRS

Name of the accounting object	Initial recognition principles in the accounting	Assessment change in accounting	Obligation and regularity	Accounting of difference	Principles of reflecting in the financial accounting
Main funds (IAS 16) Investment property (IAS 40)	Self-cost	Accounting model by the actual costs correction for losses from devaluation; Accounting model by the fair value bringing to the fair value minus losses from devaluation	At devaluation; Regularly with the fair value fluctuations	To the gains and losses of the period; To the aggregate revenues of the period/capital, at insufficiency for the financial result	Self-cost minus accumulated amortization and losses from devaluation;Revaluated cost fair value minus accumulated amortization minus losses of devaluation
Intangible assets (IAS 38)	Self-cost	Accounting model by actual expenditures correction to the losses from devaluation; Accounting model by the revaluated cost bringing to the fair value minus losses from devaluation	At devaluation; Regularly with the fair value fluctuations	To the gains and losses of the period; To the aggregate revenues of the period /capital at insufficiency for the financial result	Depreciated value, unless there was a revaluation, or current market value; By the minor: depreciated or reimbursed minus corrected amortization
Financial asset and liability (IFRS 9)	Fair value c with distribution of the difference between self-cost to the gains and losses	Model by the amortized value;Model by the fair value, corrections with change of fair value	Mandatory regularly as of the end of the reporting period; Mandatory, regularly	Partially to the gains and losses of the period;To the gains and losses of the period or the aggregate revenues of the period	Fair value minus repayment of the main debt sum plus/ minus accumulated amortization plus/minus losses of devaluation or uncollectable debt; by the fair value
Reserves (IAS 2)	Self-cost	Correction to the minor of two values: self-cost or actual selling price	Mandatory, regularly	To the gains and losses of the period	By the minor of two values:self-cost or actual selling price

Such presentation of the issue is guided by the goals of the financial accounting which are determined as information on the financial standing, financial results and money flows of the company presentation (Li and Li, 2014). We have carried out the accounting analysis of one company by the requirements of the Russian and international standards for the same period to determine the amount of differences in the indicators characterizing its financial standing. Herewith, we have applied the generally acknowledged methods of indicators calculation characterizing the financial standing. The first group of financial standing indicators are the liquidity indicators being the external characteristics of financial sustainability from the standpoint of working assets provision with long term financing resources. We have studied the changes of the most applicable liquidity coefficients: absolute, current, total; as well as critical assessment coefficients and provision with proprietary funds.

The next group of indicators characterizes financial stability: equity ratio (financial independence), borrowed capital concentration, capitalization, financing. We have as well studied the indicators of business activity reflecting the company development dynamics and quality characteristics of the financial standing. Among them: coefficients of the assets turnover ratio, moving assets turnover, assets and moving assets turnover period. Profitability ratios complete the analysis: aggregate assets profitability, non-circulating capital profitability, working capital profitability, equity capital profitability, profitability of sales. Usual methods of the indicated ratios investigation have been applied in the research process.

RESULTS AND DISCUSSION

Comparison of “Rostelecom” OJSC balance fulfilled in compliance with IFRS and RAS manifests that its structure differs mainly by the financial instruments. They have undergone considerable transformations while presentation of information by the IFRS requirements. Besides, the Chapter 1 “Dead assets” made in compliance with the RAS requirements presents inter alia Non-exclusive rights which are reflected in the item “Intangible assets” in the accounting variant transformed as per the IFRS requirements. However, the reserves movement by the items within the Chapter 1 does not influence the financial ratios, thus, making such corrections not relevant from the viewpoint of financial standing characteristics. Data presented in the first item of the balance sheet made by the IFRS requirements is somehow less than the one made by the RAS requirements. The second item “Current assets” is somehow increased in presentation made by the IFRS requirements. Thus, the correlation between the first and the second items of the financial standing report made by IFRS requirements have changed by decreasing of the dead assets share. This will render impact on the financial standing ratios as well. The

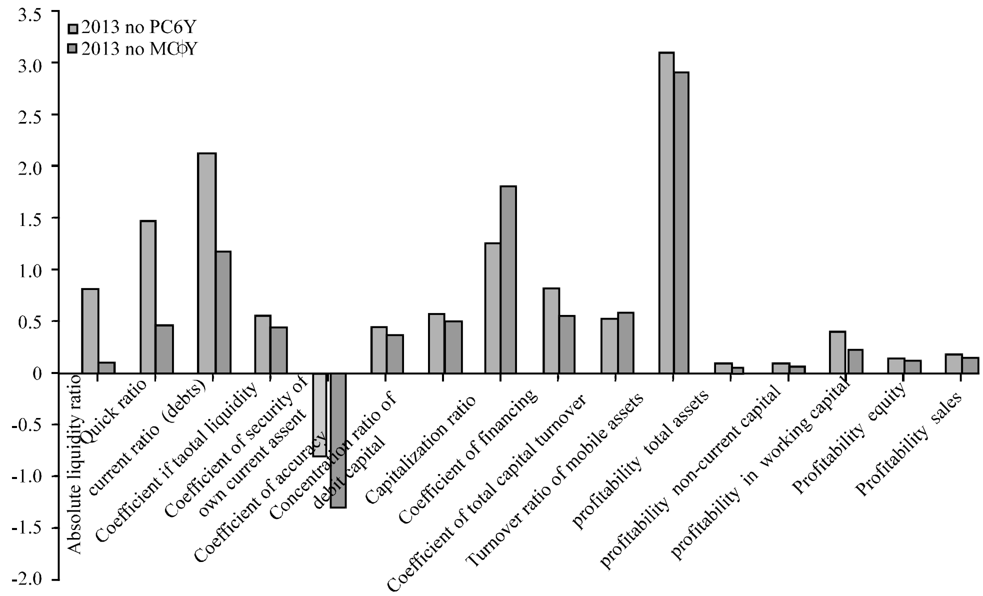

Fig. 1: Financial standing indicators by the RAS and the IFRS as of 31.12.2013

liquidity of the company data made by the RAS as of both dates looks more optimistic than the one made by the IFRS. Herewith, the absolute liquidity ratio value evaluated by the RAS as of 31.12.2014 has declined as compared with 31.12.2013 but has improved by the IFRS. Herewith, the value of this indicator being lower than the optimal value. Quick assets ratio by RAS is decreasing, as of 31.12.2014 it is considered insufficient while by the IFRS this ration is slightly growing. Current liquidity ratio by RAS as of 31.12.2014 is insufficient, showing negative tendency but close to norm, manifesting the decrease of paying capacity of the company as compared with 31.12.2013. As per IFRS the ration is showing values lower than the standard ones with the slight positive dynamics which means the slight growth of paying capacity within the same period. Total liquidity ratio within the analyzed period has increased both by IFRS and by RAS, though failing to reach the optimal value, however, by RAS it appears to be better. Asset coverage ratio has improved for the analyzed period but not reached the optimal value neither by RAS nor by IFRS, herewith, the ratios being much better in the reports made by RAS.

Equity ratio as of the analyzed period shows positive dynamics both in RAS and in IFRS format but its value gives grounds to suppose that the company liabilities cannot be met through its equity, thus making the indicator beyond the standard level. At the same time, the digital values of the equity ratio by IFRS are worse than those by RAS. Assessment of the borrowed capital integration coefficient shows the standard value with minor positive tendencies, though by RAS the coefficient being still more optimal. Capitalization and financing coefficients made by IFRS for the analyzed period were lower than the optimal value with the tendency to improvement, whereas these ratios made by RAS characterize financial sustainability more positively than those made by IFRS. On the whole, the coefficients in this group calculated by IFRS have lower values as compared with the values calculated by RAS, though the differences are insignificant.

The total equity turnover is lower if made by RAS than by IFRS. It is in line with the balance currency changes which have occurred due to the transformation. Herewith the presence period of equity in the company assets made by RAS is naturally less than by IFRS which also follows from the changes due to transformation correlations between dead and moving assets. On the whole we observe a picture similar to the liquidity, paying capacity and financial sustainability indicators which shows more beneficial characteristics of the report on the financial standing by the RAS requirements. Profitability indicators reflect a slightly altered picture as compared to other ratios that is revealing more negative data by IFRS on the background of the RAS for the preceding period and more positive data in the following one. The comparison of "Rostelecom" OJSC financial standing reports made by RAS and by IFRS requirements as of 31.12.2013 and 31.12.2014 show that the RAS requirements allow to make more positive conclusions by this accounting data. The ratio values calculated on the basis of the RAS and the IFRS requirements are summed up in the Fig.1 and 2.

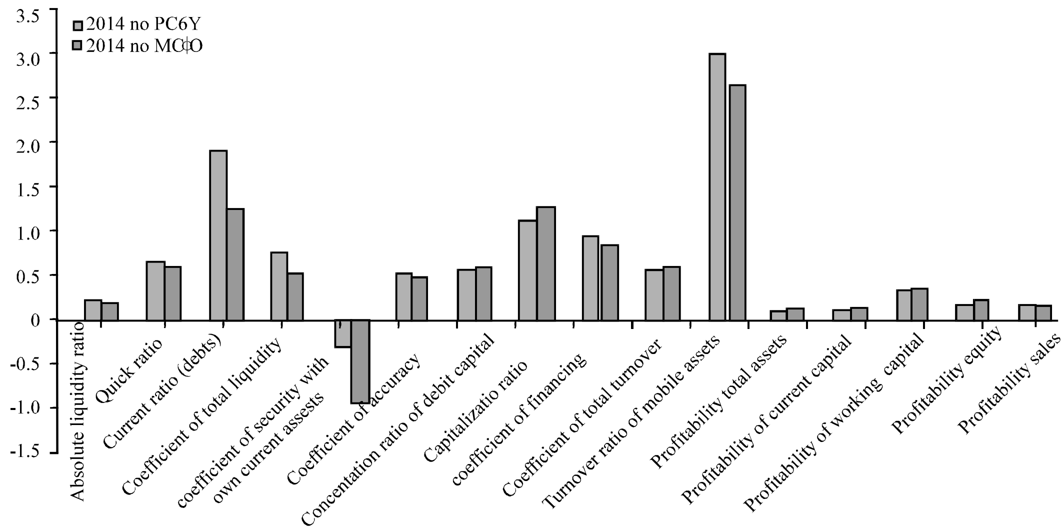

Fig. 2: Financial standing indicators by the RAS and the IFRS as of 31.12.2014

The data on the Fig. 1 and 2 demonstrate that the majority of the “Rostelecom” LLC financial standing indicators as per the reports made by PAS present the better picture than the indicators made by the IFRS. However, it is evident that difference in the coefficients is largely very significant. Herewith, the liquidity and profitability indicators differ by 30 and more percent, paying capacity and financial sustainability coefficients largely within the limits of 30%. The smallest differences can be witnessed within the capital utilization efficiency indicators. The research has revealed, that the smallest differences occurs between the coefficients which are calculated in respect of the balance currency or by the data from the assets and liabilities; this fact occurs due to the correcting tools by the accounting transformation which bring to the parallel growth both of the balance currency and of separate items.

We have carried out the integral assessment by points of the “Rostelecom” LLC financial standing indicators considering a large number of coefficients subject to systematization of their dynamic changes, differences in their meanings by the RAS and IFRS requirements. Herewith, we have used the following indicators:

$$\text{Absolute liquidity ratio} = \frac{\text{Liquid current assets}}{\text{Current liabilities}}$$

$$\text{Ratio of critical assessment} = \frac{\text{Short term receivables+Short term investments+cash}}{\text{Current liabilities}}$$

$$\text{Current ratio} = \frac{\text{Liquid current assets}}{\text{Current liabilities}}$$

$$\text{Finanical independence ratio} = \frac{\text{Equity and reserves}}{\text{Total assets}}$$

$$\text{Ratio of own source of revenue} = \frac{\text{Working capital}}{\text{Current assets}}$$

$$\text{Finanical independent ratio in the formation of reserves and expenses} = \frac{\text{Working capital}}{\text{Inventory cost}}$$

The results of financial standing indicators ranging by the RAS data are represented in the Table 3; they enable to make conclusions, that as of 31.12.2013 the company has enjoyed a good financial standing (2nd class), as of 31.12.2014 its financial standing has changed for the worse to reach the 4th class of financial sustainability which means that the company has a favorable financial standing but there exists a risk of bankruptcy.

The results of financial standing indicators ranging by the IFRS data are represented in the Table 3; they enable to make conclusions that as of 31.12.2013 the company has evidenced an unfavorable financial standing (the 5th class), as of 31.12.2014 its financial standing has improved to the 4th class which means that the company has a favorable financial standing but there exists a risk of bankruptcy. Thus, as of 31.12.2014 the financial standing of “Rostelecom” LLC is equal in both formats.

Table 3: The number of accumulated points characterizing the financial standing of Rostelecom LLC by RAS and IFRS requirements within the period of 2013-2014

	Indicators by RAS data (31.12.2013-14)				Indicators by IFRS data (31.12.2013-14)			
Financial standing indicators	Values	No of points	Values	No of points	Values	No of points	Values	No of points
Absolute liquidity coefficient	0.811	20.00	0.165	6.60	0.074	0	0.153	6.12
Quick ratio	1.46	16.80	0.634	0.00	0.439	0	0.58	0.00
Current liquidity coefficient	2.145	16.50	1.901	15.02	1.17	4.05	1.233	5.00
Equity ratio (financial autonomy)	0.444	4.52	0.478	7.24	0.356	0	0.447	4.76
Own current assets coverage coefficient	-1.584	0.00	-2.718	0.00	-1.319	0	-2.944	0.00
Equity ratio for reserves and expenditures formation	50.581	13.50	46.281	13.50	2.06	13.5	45.362	13.50
Total	x 71.32	x	42.36	x	17.55	x	29.38	

CONCLUSION

The carried out research demonstrated that it is of no importance, what interpretation has been applied for the purposes of the accounting data on the financial standing of a company study; the conclusions of the user will differ insufficiently. At the same time, the current research bears the unsettled issues of mutual connection and impact of the definite recalculations carried out with the items of the report on the financial standing and coefficients change which enables to assess the risks of considerable misstatement of the report on the financial standing by IFRS with the purpose of manipulation the involved users and public opinion, particularly those of the Russian public companies. This aspect will become the subject of the further investigation.

REFERENCES

Aktas, R. and M. Kargin, 2011. Timeliness of reporting and the quality of financial information. Int. Res. J. Finance Eco., pp:71-77.

Beutler, I.F., 2014. What makes wealth grow? A wealth sensitive financial statement analysis. J. Financial Counseling Plan., 25: 90-401.

Chan, J.L., 2008. International public sector accounting standards: Conceptual and institutional issues. Harmonization Government, 21: 1-15.

Filip, A., R. Labelle and S. Rousseau, 2015. Legal regime and financial reporting quality. Contemp. Accounting Res., 32: 280-307.

Gil, D., 2004. The role of sophisticated accounting system in strategy management. Int. J. Digital Accounting Res., 4: 125-144.

Griffin, J.B., 2014. The effects of uncertainty and disclosure on auditors' fair value materiality decisions. J. Accounting Res., 52: 1165-1193.

Klychova, G.S., L.N. Safiullin and A.R. Zakirova, 2014. Information-analitical support of cost management in horse breeding. Mediterr. J. Soc. Sci., 5: 193-196.

Li, Y.J. and R. Li, 2014. Research on financial statements system based on enterprise resource. Proceedings of 2013 4th International Asia Conference on Industrial Engineering and Management Innovation (IEMI2013), December 2-2, 2013, Springer, Berlin, Germany, ISBN:978-3-642-40059-9, pp: 389-399.

Needles, B.E., A. Shigaev, M. Powers and M.L. Frigo, 2010. Strategy and integrated financial ratio performance measures: A longitudinal multi-country study of high performance companies. Stud. Managerial Financial Accounting, 20: 211-252.

Needles, B.E.Jr., A. Shigaev, M. Powers and M.L. Frigo, 2014. Operating characteristics of high performance companies: Strategic direction for management. Stud. Managerial Financial Accounting, 28: 25-51.

Pedler, M. and J. Berkon, 1991. The Learning Company: A Strategy for Sustainable Development. McGraw-Hill, New York, pp: 41.

Peltoniemi, M., 2011. Reviewing industry life-cycle theory: Avenues for future research. Int. J. Manage. Rev., 13: 349-375.

Potehkina, E.N., 2014. Problems and ways of accounting for small enterprises. Fundam. Res., 9: 1322-1325.

Senge, P.M., 1990. The Fifth Discipline: The Art and Practice of the Learning Organization. Doubleday/Currency, New York, USA, ISBN-13: 9780385260947, Pages: 424.