ABSTRACT

The objective of this paper is to promote accounting culture and the registered progress regarding the presentation and evaluation of the financial instruments within the annual accounts of the entity and the way in which the accounting treatment that can be applied to these elements can influence the information that makes the subject of economical and financial communication.

KEY WORDS: international financial reporting standard; financial instruments; financial communication.

1. INTRODUCTION

European companies that operate at an international level, still face difficulties regarding the drawing up of the annual financial statements according to the national accounting rules, the community accounting directives or the international financial reporting standard IAS/IFRS.

Regarding the financial instruments used by listed companies that draw up their financial statements according to the international accounting regulations, they are treated according to IAS 39 from the presentation and evaluation point of view and the information that refers to their existence is presented according to IFRS 7 – Financial instruments: Information to be provided.

From the 1st of January 2013, IFRS 13 entered into force and stands right next to IAS 39, with the purpose of determining the calculation method for the “fair value” regarding financial assets and liabilities. This standard gives fair value a new definition, namely: “The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”. In a project elaborated by the International Accounting Standard Board, the complete replacement of the IAS 39 standard is stipulated, because it considered too complex to be understood and applied as to be able to offer a credible evaluation of the financial instruments. Thus, in 2010 the IFRS 9 standard was elaborated and its applicability will become compulsory from January 2015, because it isn’t yet regulated by the EC.

2. IAS 32 AND IAS 39 – DEFINING AND EVALUATING THE FINANCIAL INSTRUMENTS

The financial instruments are a very important subject for the international community, in the accounting attunement process. The development that took place in the 1980s, determined IASC to undertake a project, in 1989, that was oriented towards drawing up the international accounting standards with relation to this issue. The results were presented in “Exposure Draft”(1991) and “Exposure Draft E 48 – Financial Instruments”(1994), the second one being criticized heavily, situation which determined IASC to separate the implementation of the E48 project in two phases.

The first phase, which ended in 1995 led to the elaboration of IAS32 – Financial Instruments – Presentation; which entered into normal use starting with the 1st of January 1996. The second phase, which ended in December 1998, led to the approval of IAS 39 “Financial Instruments – Presentation and Evaluation”1, which entered normal use starting with the 1st of January 2001.

IAS 39 reviews certain themes (definitions and integrative information), that were laid out in IAS 32 and gives them more amplitude and deepens them.

During the elaboration of the two standards, the tight relation between them is signaled with precision, thus justifying why we characterized them together in this paper.

At the end of the chapter, we will highlight the choice possibilities regarding the application of the two standards in the financial community and the answer that IASB gave in the meantime, in order to mitigate the contents of these standards.

1Considering the complexity of the applicability of IAS 39, IASC considered that it is necessary to create a implementation guide for it, listed as Questions and Answers(Q81).
3. THE PURPOSE AND DOMAIN IN WHICH IAS 32 AND IAS 39 ARE APPLIED

A financial instrument is noted in the balance sheet for the first time only when the entity becomes part of the contract that identifies that respective instrument.

IAS 39 – disposes the initial highlighting of an acquisition of financial assets, at the negotiation date, which is viewed as the date at which the entity engages in acquiring that asset. At the same time, for regular acquisitions the possibility of accounting them at the date in which they enter the patrimony of the entity, which is viewed as the date at which the asset is consigned to the entity. The chosen method shows a different result, judging by the category in which the financial instrument belongs.

In the initial highlighting of financial assets and liabilities, transition costs are included, which are viewed as peripheral costs that are attributed directly to the acquisition or outgo of a financial asset or liability. Included in the transition costs are the taxes and commissions paid by the entity, operators and mediators, taxes and contributions which derive from transfers. Not included, are discounts, prizes, financing costs or the internal allotment of costs regarding administration or stewardship.

4. THE SUCCESSIVE EVALUATION OF FINANCIAL ASSETS AND LIABILITIES

IAS 39 stipulates the classification of financial assets and liabilities into categories, in order to create a special accounting treatment for each class. In order to categorize financial assets, a criteria that usually starts from the liquidity factor and takes into account the capacity of the assets to produce return or loss when it is negotiated for a short period of time was used [1]. There are 4 categories of financial assets:

a) assets detained with the purpose of being negotiated (held for trading), are treated like financial assets (participations and titles that re-entered the circulatory assets) that are bought to make a profit, as a result of short term price fluctuations, or ordered by the entity with the aim to make profit through cession on a short period of time. The inclusion in the “held for trading” category appears because not only is the intention obvious, but also the habit of the entity to use this operation method, independent of the reasons that were behind the asset acquisition. As a part of this category are the assets that are meant to be sold as derived products, except the coverage instruments.

b) assets held to maturity – the assets that generate fixed or determined payments with the overdue stipulated in the contract. Besides these subjective requirements, IAS 39 defines the subsequent conditions, to make it possible for an financial asset to enter one of these categories:
   - the intention to hold the asset till overdue;
   - the capacity of the entity to hold the asset till overdue;

Regarding the accounting treatment, the “held to maturity” category is evaluated at the amortized cost, and the eventual losses from value depreciation are recorded in the income statement[3]. Besides this, IAS 39 constitutes the conditions in which an asset can be excluded from the held to maturity category:
   - the entity owns assets for an indefinite period of time;
   - faced with liquidity exigency it doesn’t change products on the market, also the entity is inclined to align the financial assets;
   - the issuer has the right to reimburse the financial assets at a significant lower value as opposed to the amortization value;

Another forbidden element is represented by the impossibility of the entity to qualify a financial asset as “held to maturity”, when in the current accounting period or in the two years before it, the entity transferred or sold the asset, before the overdue, for irrelevant profits regarding the assets that were classified in this category.

The waiver from interdiction can be made if:
   - the sales were made after the overdue date of that asset, with the purpose of having a uniformed balance sheet value at the just value;
   - the entity already cashed the capital quota for the scheduled payments;
   - the sales are isolated, occasional and unforeseen;

The available for sale assets are a residual category that includes financial assets that can’t be added in other categories. From an accounting point of view, assets available for sale are evaluated at the just value and the pluses and minuses resulted are noted in the income statement or in a certain special reserve in the balance sheet, that can be then transferred to the income statement. In the rare situation in which the real value can’t be determined credibly, assets are evaluated at the net cost that corresponds to value loss.

Liabilities are classified in two categories, from the criteria usually used for these categories and representing chargeability:
   a) liabilities held with the purpose to be sold are represented by derivates and unveiled asset sales. In accounting, these liabilities are evaluated at the just value and having the imputation noted in the income statement.
b) liabilities created by entities have their roots in derived debts, from goods and services acquisition and from loans made by the same entity. The liabilities created by the entity must be evaluated at the amortized cost, while noting in the income statement the possible value loss.

5. FAIR VALUE DEFINITION IN THE IAS 39

One of the main modifications brought by the introduction of the International Financial Report Standards is just value and points out directly to IAS 39, presenting the evaluation criteria not only for financial derivates, but also for assets ready for sale, or assets and liabilities that can be sold.

IAS 32 defines fair value as the “exchange value afferent to assets and liabilities between two contracted parts, while knowing that the market is active”. Thus, the just value implies the existence and encounter of autonomous operators that have sufficient information referring to the goods exchange and decide on the spot to use it. IAS 32 – excludes the value the entity would pay or receive in an enforced operation, involuntary liquidation or a sale that is too cheap from the definition of the just value. According to the definition, IAS excludes the possibility to consider that the fair value, the exchange price of financial instruments between entities that share the same group, are not considered independent members.

An important consideration that needs to be noted is the necessity of not mixing up the concept of fair value with the market price, a very common error in practice. It could be determined using techniques that stimulate market value. We will describe these techniques later on. Therefore, in concordance with IAS 32, only in the presence of an asset and liability market, the market value is the same as the fair value, or is at least a fundamental parameter of reference for its calculation. The parameters used for defining an active market are:
- the volume of changes;
- the assiduity of the partnerships;
- the availability of the operators to exchange goods based on the existing prices on the market;

In case the market is not very active (over the counter markets) or “thin” from the quantity of sales, the market prices cannot correctly indicate the just value of the financial instruments. In these circumstances, like when the market price isn’t readable, the just value can be determined by making technical estimates (discount, cash flow or option pricing model), using, if possible measures designed solely for the market (for example the return rate used in updating operations).

In the hypothesis in which the financial instruments that need to be evaluated, were not negotiated on an organized market, the appropriation of a single value could in turn give a fair value; by doing this it could result in the finding of a value, from which the fair value can be allocated rationally[2],[3].

6. DERIVATE FINANCIAL INSTRUMENTS – DEFINITION AND ACCOUNTABILITY BASED ON IAS 39

Another out of the ordinary thing in the International Standards regarding financial instruments makes reference to the definition and accounting of derivate instruments.

IAS 39, besides enlarging the definition from IAS 32, also individualizes three necessary specifications for the purpose of classifying a financial instrument as a derivate [3]:
- the variability of the value that the instrument has, as an effect of verified changes on an financial asset (underlying asset); the specific return rate; commercial paper prices; material prices, exchange or return rates, price or rate indicators; credit indicators (rating) and other parameters.
- the absence or reduction of initial investments towards other types of contracts which show the same amendments as a result of variations in market value;
- regulation or execution at a future time;

For the purpose of individualizing derivate categories, IAS 39 adopts the specification defining criteria, thus avoiding the creation of a situation deemed old and unusable because of the multiplication of the instruments. Also, IAS 39 brings the hypothesis in which a financial instrument, that present all the requirements presented beforehand in order to be classified as a derivate must not be treated this way from an accounting point of view. The operation and evaluation of derivate instruments follow the general guidelines that are found in IAS 39.

Thus, derivate financial instruments are operated and highlighted at the trading date, independent to any financial change and any obligation fulfillment from those implicated, this way excluding the possibility for goods to be highlighted at the settlement date. An option like this is kept for “regular way” instruments or acquisition and sale contracts for assets, characterized by declaring the goods in a given number of working days. In paragraph 28 of IAS 39 a innovative principle is presented as opposed to the national practice; a entity will highlight in its balance sheet all the rights and obligations enforced by the contract, that surface from the derivate financial instruments as assets or liabilities.

---

2 It is shown that derivates sold in the EU, have the possibility of regulation positions, highlighting only the balance of financial operations even without noting the asset that was used in that transaction.
Regarding the successive highlighting, derivates will be operated at the fair value, with the variations noted in the income statement with the presumption of including the derivates in the category of assets and liabilities owned and ready for sale. The following derivate instruments don’t fall under these rules:
- those for which base assets aren’t evaluated in a credible way, because they weren’t negotiated on regulated markets;
- some depreciation instruments that emphasize keeping reserves from differences obtained from just value growth;
- instruments incorporated in hybrid titles, for which a separate highlighting isn’t necessary;

7. THE EVOLUTION OF IAS 39 LED TO THE BIRTH OF IFRS 9

At the end of 2008, IASB wanted to simplify IAS 39, by creating a new standard, IFRS 9. The initial project was to present IFRS 9 when it was entirely finished and could be put to replace IAS 39 from all points of view. Instead, because of the numerous requests coming for the market, IASB has created a first version of IFRS 9 that hasn’t yet been adopted by the EC, version that contains only the classification and evaluation of financial instruments. The creation of the IFRS 9 had 3 stages, as follows [6]:

**Phase 1 – Classification and Measurement:** In November – “IFRS 9 Financial Instrument”, this first edition refers to the thematic of classification and evaluation of financial assets. In October 2010, a new version of IFRS 9 was published, that presents only aspects referring to liabilities, especially the accounting treatments that can be applied, which show a big similarity to those presented in IAS 39, but also a great difference when it comes to the evaluating them to the fair value option. This document has not yet been regulated by the EC, thus IASB can bring new modifications.

**Phase 2 – Impairment methodology:** In November 2009, the “Exposure Draft Amortized Cost and Impairment” was elaborated, and on the 31st of November of the same year IASB published “Financial Instrument: Impairment con supplement all’exposure draft”. All debates referring to this document ended on the 1st of April 2011, and in 2012 “Re-exposure draft” was published, which was subsequently improved and modified.

**Phase 3 – Hedge Accounting:** Exposure Draft “Hedge Accounting”, published at the end of 2010. In September 2012, “ReExposure Draft” was elaborated. It contains general aspect referring to hedge accounting. In 2013, the first Discussion paper regarding “Macro Hedge Accounting” was published.

8. CONCLUSIONS

We consider that the purpose of IFRS 9 is to guarantee a high transparency even after the financial crisis. The modification brought by IFRS 7 constitute a specific rundown of the just value hierarchy, namely the fact that entities need to correctly defined three levels of just value and must subsequently report them[5]. The first level refers to a financial instrument quoted on an active market, the second one states that the just value must be determined with evaluation techniques that take into account observable market parameters, while in the third level, the just value is determined with evaluation techniques that take into account parameters that cannot be identified on the market.

We must also state that IFRS 7 imposes the fact that level transfers must be indicated and the modification must be justified and explained. Also we must state that IFRS 9 provides that the classification of a financial asset can be made at the amortized cost or alternatively at the just value, judging by the way the entity manages financial assets and cash-flow obtained. Also, from the financial liabilities point of view, IFRS 9 holds the same evaluation and classification criteria that IAS 39 enforced, the exception being liabilities classified by fair value option.

Regarding IFRS 13, we must conclude that it introduces the concept of Exit price, it considers as specifications of assets and liabilities, the conditions, placing, restrictions regarding selling and using; the just value of a debt must reflect the risk of not bringing a profit, excludes transaction costs and includes transportation costs.

Acknowledgment

This paper has been financially supported within the project entitled „SOCERT. Knowledge society, dynamism through research”, contract number POSDRU/159/1.5/S/132406. This project is co-financed by European Social Fund through Sectoral Operational Programme for Human Resources Development 2007-2013. Investing in people!”

**BIBLIOGRAPHY**