

THE UTILITY OF ACCOUNTING POLICIES FOR FINANCIAL REPORTING

Vilena TIȘCENCO

*Stefan cel Mare University of Suceava, 720229, Romania /
Academy of Economic Studies of Moldova, Chisinau, Republic of Moldova*
vilenatiscenco1996@gmail.com

Galina BĂDICU

Academy of Economic Studies of Moldova, Chisinau, Republic of Moldova
badicu.galina@ase.md**Abstract**

In an increasingly globalized and complex world, the efficient management of the activity of economic entities becomes a vital necessity for achieving success and competitiveness in the market. Accounting policies are a crucial aspect of this management, as they directly influence how financial information is presented, interpreted and used within organizations. To ensure efficient management of the activity, economic entities must adopt the appropriate accounting policies that correctly reflect their financial situation and performance. The refinement of these accounting policies becomes essential in the context of a continuously evolving economic environment and increasingly rigorous requirements of users of financial information. It has already been proven that the very presentation of business transactions can be done in completely different ways, leading to varied financial results. Having a considerable source of bibliographic sources and international normative acts, a qualitative analysis can be carried out regarding the utility of accounting policies for financial reporting.

Keywords: *accounting policies; financial position; financial results; financial statements; users of financial statements.*

JEL Classification: *M42.*

I. INTRODUCTION

Reliable and complete financial data is crucial for making business and investment decisions. Users of financial statements must trust the information presented, and organizations must be transparent and apply appropriate accounting policies to guarantee that trust (see Figure 1).

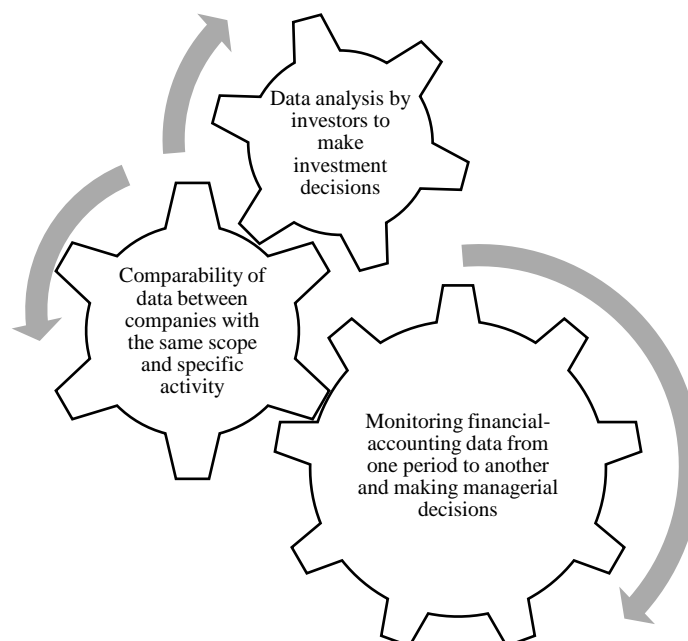


Figure 1. Essential directions for use of financial statements

Source: developed by the author based on 24th Extract from the EECS's Database of Enforcement (2020)

To ensure data reliability, organizations apply accounting policies to measure, record and report financial transactions and events. These accounting policies are important because they can significantly affect a company's

financial results and financial position. For example, a company that uses more conservative accounting methods may have lower profits but be more financially stable than a company that applies more aggressive accounting policies (Dima & Dima, 2017).

To obtain complete data, organizations must pay attention to detail and record all relevant financial transactions correctly. In addition, financial information must be presented in a clear and concise manner so that it can be understood by all users.

Users of financial statements, such as shareholders, creditors, investors and financial analysts, rely on financial information to make important business and investment decisions. That is why it is essential that the data presented in the financial statements are reliable, complete and relevant.

II. ACCOUNTING POLICIES TOOL AS AN ESSENTIAL PART OF FINANCIAL DATA PREPARATION

In the context of this scientific approach, we would like to note that the current regulations in the field of accounting allow, sometimes at the limit, the selection of an option, and entities take advantage of the inconsistency in the legislative rules to ease their tax burden as much as possible. At the same time, the freedom of choice, launched by the standardizers through the existence of several accounting options, can influence both the entity's financial position and performance, as well as certain economic indicators, such as solvency and the degree of indebtedness (Cazacu & Caraiman, 2018).

Next, we propose to emphasize some advantages, identified by the author, of the accounting policies through the lens of the obligations imposed by the accounting regulations, a fact presented in the figure below.

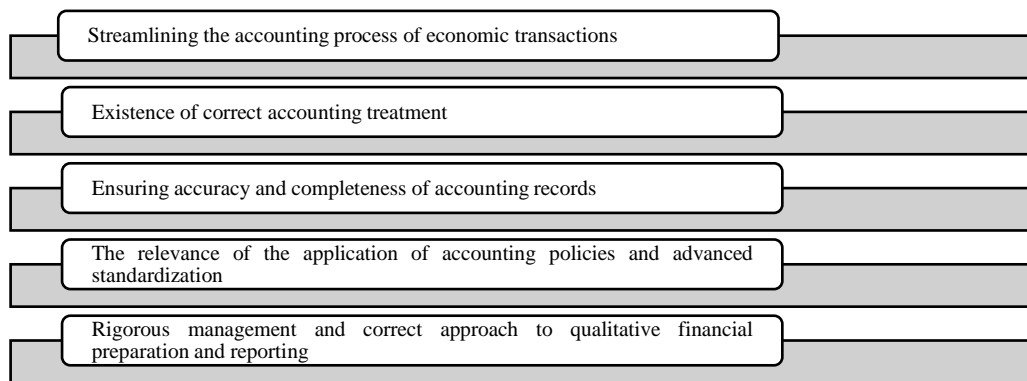


Figure 2. The advantages of accounting policies for the preparation of financial statements

Source: developed by the author based on Dascălu (2020)

From Figure 2, the following conclusions can be drawn regarding the strengths of adequately developed accounting policies. By streamlining the accounting process of economic transactions, properly developed accounting policies can simplify the decision-making process, for example by automating financial transactions in the entity's accounting system, developing procedures and new guidelines for the standardization of future changes, which will allow updates and a diverse approach in practice.

In order to ensure appropriate accounting policies and applicable accounting regulations, in the context of complex accounting problems, the presence of a correct accounting treatment of transactions is relevant. Thus, accounting policies are important to the success of an entity because accounting regulations allow alternative treatments for the same accounting transaction (Grosu, 2020, p. 224).

In order to guarantee the systematic evaluation of the accounting records and the respect of the selected options regarding the processing, in the same way, of the transactions, the accounting policies have an additional purpose in the case of the mandatory audit of the financial statements. In this context, accounting policies serve as evidence, given the existence of cases where accounting regulations allow alternative treatments for the same transaction, ensuring the accuracy and completeness of accounting records. In the general context regarding the accounting policies, the objective of the auditor must also be taken into account, which in order to know the entity and its environment must understand how the accounting policies were selected and applied by the audited entity, including the reasons for their change. The auditor must also assess whether the accounting policies applied are appropriate to the entity's activity, are consistent with the applicable financial reporting framework and the entity's strategies (Trivellas & Trivellas, 2018). In order to anticipate the impacts of future accounting changes, eloquence in the application of accounting policies and advanced standardization will help to evaluate accounting transactions in a similar manner, as well as to standardize processes aimed at consistency and compliance.

For the purposes of economic decision-making and financial reporting, we believe that rigorous management and the correct approach to the preparation and reporting of accounting information are useful and

compliant with applicable accounting regulations in order to ensure the quality of financial statements.

Accounting policies guide the company's finance and accounting department on how to prepare financial reports for both internal and external review. These policies help maintain consistency in reporting by ensuring that the same techniques are used over different periods of time, while also ensuring that the company remains compliant with any statutory or legislative requirements.

III. ACCOUNTING POLICIES TOOL AS AN ESSENTIAL PART OF FINANCIAL DATA PRESENTATION

Accounting policies used inappropriately or erroneously can significantly affect the financial position of an economic entity. If a company uses accounting policies that are not appropriate or that do not comply with international accounting standards (IFRS), this can lead to the presentation of an incorrect picture of its financial results and financial position.

Thus, the use of inappropriate or erroneous accounting policies can lead to the presentation of an incorrect picture of the financial results and financial position of an economic entity, which can affect the business and investment decisions of users of financial statements. Therefore, it is important that economic entities comply with international accounting standards and apply appropriate accounting policies to ensure a fair and complete presentation of their financial situation (De George, 2015; Kimmel et al., 2021, p. 864).

With the establishment of international reporting provisions, the phenomenon of flexibility in the application of own accounting policies appears, designed to satisfy any specific aspect of an economic activity carried out on the territory of the country.

The financial position presents *our assets, liabilities and equity* as elements directly related to its valuation (Cobzari et al., 2015). Along with these, there are also factors that influence, directly or indirectly, the first one (see Figure 3):

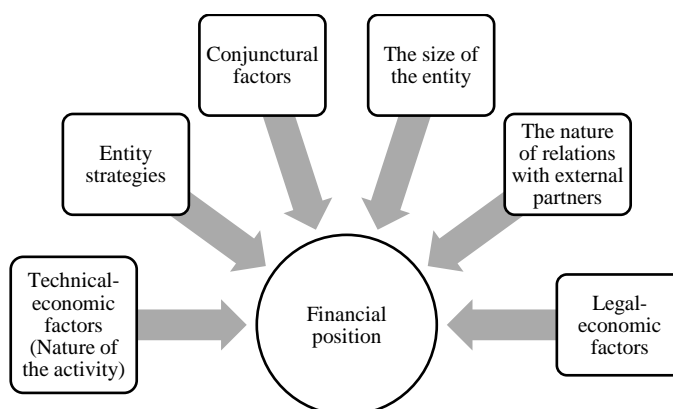


Figure 3. The factors influencing the financial position

Source: developed by the author based on Dănuleşiu (2018)

In addition to the uses of accounting policy listed above, there are a multitude of possible manipulations of income and expenses using accruals and deferrals, i.e. recognizing income and expenses too early or too late, which is a favorite creative accounting tool.

The purpose of these strategies is to increase the value of the company to increase the wealth of managers through various company incentives such as bonuses or company stock options or to shift profits to a later period when these incentives can be realized. Similarly, company profits can be hidden for the purposes of tax avoidance and/or creation of hidden reserves (Amarfii-Railean, 2020).

In the author's view, the following definition of accounting policies would be drawn up - *the set of rules and guidelines regarding the correct preparation and appropriate disclosure of financial-accounting information that allow the creation of a faithful and consistent image, through the registration, recognition and adequate evaluation of the elements the balance sheet, as well as facilitates comparison (both between different periods and between different entities with similar specifics of economic activity), for keeping an eye on the financial position and performance, but also for making managerial decisions, in order to maintain or increase competitiveness.*

When drawing up accounting policies by specialists in the economic and technical field, familiar with the activity of the entity and its strategy, the specifics of the activity of the respective entity, the economic context in which it carries out its activity and the requirements contained in the applicable accounting regulations must be taken into account (Bădicu & Mihaila, 2014; Mykhayliv et al., 2020). At the same time, the provisions of each accounting standard must be taken into account, which contain explicit rules regarding the application of accounting policies for the economic facts regulated by them (see Figure 4).

Evaluation rules:	<ul style="list-style-type: none"> • On the date of entry into the entity; • On the date of deregistration; • Upon exiting the entity; • On the balance sheet.
Evaluation bases:	<ul style="list-style-type: none"> • At historical cost; • At the revalued value, in the case of tangible assets; • At the net realizable value, in the case of stocks; • At the probable collection/payment value, in the case of receivables and payables; • At the book value, in the case of equity, etc.
Accounting conventions:	<ul style="list-style-type: none"> • Historical cost; • Fair value; • Accrual accounting; • Business continuity from the exploitation activity.
Specific practices:	<ul style="list-style-type: none"> • Practices regarding the level of detail of the associated information (accounting policies, in the case of listed entities); • Practices regarding the extension of "accounting choices" in terms of accounting policies, options, estimates, accounting treatments.

Figure 4. Structuring the defining elements of accounting policies

Source: developed by the author based on IAS 1, IAS 8, IAS 10.

Like any family that sets its own rules in order to live in harmony, economic entities also develop their own set of accounting policies that serve as a guide in keeping accounts, as well as coherent and complete presentation of financial statements, respectively, state in a manner express and the accounting options applied by them on the elements of the accounting balance sheet. Based on universally valid international accounting standards and, in particular, national standards applicable on the territory of the Republic of Moldova, accounting policies remain essential in ensuring the coherence and economic stability of an entity that carries out its economic activity on the territory of the country (Tişenco & Bădicu, 2022).

The purpose of complying with these international standards is, on the other hand, to allow users (employees, investors, creditors, suppliers, customers, government and the public, in the case of public interest entities) to understand the impact of certain "economic phenomena in words and figures", other events and conditions on the financial position and financial performance. At the same time, it is also necessary to verify all the data included in the preparation of the financial statements, so that the degree of accuracy of the economic phenomena is maximum, thus assuring the users with truthful and quality information (Бурсулая, 2020).

Based on these monitorings, supported and reasoned decisions can be made that condition future progress. The comparability of similar data from another period would also serve as a more meaningful choice between the alternatives existing at that time. Comparative information, in turn, serves as raw material for narrative and descriptive information relevant to understanding the current period's financial statements (Atkinson et al., 2021, p. 800).

Accordingly, in Figure 5 we find the users of financial-accounting information listed as follows:

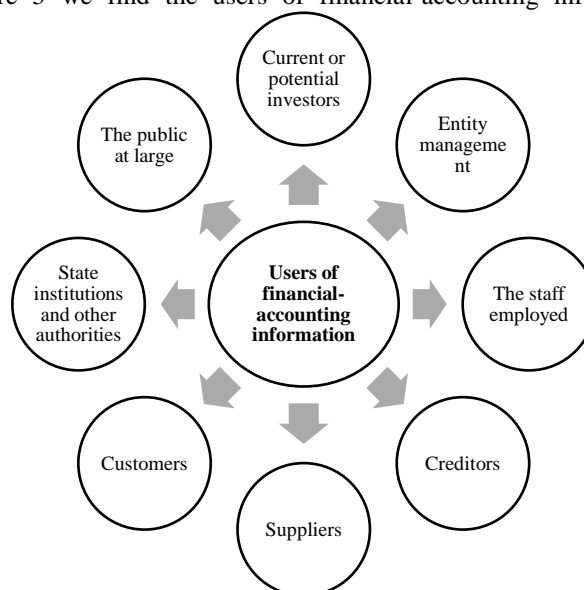


Figure 5. The main consumers of financial-accounting information

Source: developed by the author based on Бурсулая (2020)

Users of financial-accounting information rely on the trust that the information disseminated through the financial statements corresponds to the reality of the reporting entities, and the main advantages of accounting policies according to Dascălu (2020) include:

- ✓ managing and correctly approaching the preparation and reporting of financial information that is useful in making economic decisions and in accordance with accounting regulations;
- ✓ consistency in the application of policies and increased standardization by anticipating the impact of future accounting changes;
- ✓ correct accounting treatment – ensuring applicable financial policies and regulations;
- ✓ streamlining the accounting process;
- ✓ documentation requirements – ensuring the accuracy and completeness of accounting records;
- ✓ avoiding internal control deficiencies through standardized controls.

In this context, we note that an understanding of the entity's *selection and application of accounting policies* may include aspects such as:

- the methods the entity uses to account for significant and unusual transactions;
- the effect of significant accounting policies in controversial or developing areas for which there is a lack of normative guidance or consensus;
- changes in the entity's accounting policies;
- financial reporting standards, laws and regulations that are new to the entity, and when and how the entity will adopt these requirements (Gaber, 2020).

As for the actual accounting policies, the specialized literature does not exemplify them, leaving it up to the entities to develop them, depending on the needs. The investigation of bibliographic sources (Bellucci & Liberatore, 2019; Kimmel et al., 2021, p. 864; Socoliuc & Grosu, 2015) allowed us to find that the accounting policies adapted to the specifics of the entity constitute a valuable work tool with triple application value.

First of all, it serves accounting in the correct approach, from a legal point of view and in the interest of the entity, of accounting operations and presentation of accounting information within individual financial statements. But many companies underestimate the importance of accounting policy, interpreting it formally, and therefore do not take into account the effects that lead to ineffective management of the entity, because various indicators of economic activity, such as production costs, expenses, income, taxes and others depend on the option chosen.

Secondly, the accounting policies are a control element at the management's disposal, with the help of which it permanently monitors, until the end of each management period, the aspects related to the status of the established objectives, the observance of legality in the treatment of economic facts, the identification of new alternatives for the development them and, finally, the timely and correct taking of the necessary decisions. In this context, the entity must choose and apply the accounting policies so that the financial statements comply with all the requirements of the applicable accounting regulations.

Thirdly, it serves as a relevant tool in the audit mission in order to verify the compliance of the actuality and completeness of the accounting policies, the agreement with the applied accounting principles, methods and techniques, as well as the assessment of the degree of influence of the applied accounting policies of the audited entity on the reliability of the statements its finances.

From this triple vision, accounting policies can be a mechanism of mitigating action aimed at directing the communication of different people towards a joint solution of problems or a fulfillment of objectives. However, unfounded and inconsistently applied accounting policies can lead to a bad integration of the entity in the external environment and the creation of an internal environment unfavorable to the achievement of the entity's performance objectives.

Generalizing, we conclude that the need to develop accounting policies results from the need to establish the conditions under which certain operations are carried out that have an impact on the entity's accounting and, finally, from the fact that accounting information is the basis of the decisions taken by the entity's management. At the same time, any entity needs a benchmark system that is given by the accounting policies, but also a control system of how it is applied. Accounting policies cannot be standardized, because they must be adapted to the specific activity of the entities. However, the accounting rules and treatments adopted by the accounting policies must be those provided by the applicable accounting regulations.

In our opinion, accounting policies are an extremely useful working tool, as they are an integral part of the annual financial statements, so that information users understand the meaning of the presented indicators. Also, the accounting policies ensure the uniform application of the accounting treatments and eliminate possible erroneous interpretations given to some activities of the entities. The accounting rules and treatments contained in the accounting policies must comply with the applicable accounting legislation as a whole. In this sense, it is not enough just to comply with the accounting regulation, because there may be provisions in the legislation that regulate some fields of activity and that may lead to specific records in the accounting. In addition, accounting policies function as a useful and comprehensive guide regarding the treatment of future transactions that the entity may face.

IV. CONCLUSION AND RECOMMENDATIONS

At the end of this study, it can be firmly stated that both from a theoretical perspective, but especially from a bibliographic one, topics and analogous situations were researched and examined, which had as their fundamental objective the determination of the present link between the quality of the promoted accounting policies and efficient management of the economic entity.

Thus, the general conclusions on the researched topic would be the following:

1. Adequate and well-defined accounting policies play a crucial role in the efficient management of the activity of economic entities. They provide a clear framework for recording and presenting financial information and contribute to informed decision-making.

2. Improving accounting policies in accordance with relevant accounting standards is essential to ensure transparency and comparability of financial information between entities.

3. The adoption of International Financial Reporting Standards (IFRS) can facilitate the comparability of financial results between entities in different countries and increase the confidence of investors and other interested parties in the information presented.

4. The correct understanding and application of the relevant accounting policies are crucial for presenting the entity's result transparently and accurately. Thus, professional accountants must be well trained and up-to-date on accounting standards and practices.

The general recommendations could be formulated in this form:

I. Improving the education and training of accounting professionals in the field of accounting policies and financial reporting standards. Continuous updating of knowledge and skills is essential to stay abreast of developments and changes in the field.

II. Promoting transparency and ethics in the application of accounting policies. Adherence to ethical principles in accounting is crucial to ensuring the integrity of financial information and confidence in the results presented.

III. Collaboration and exchange of best practices between economic entities and accounting professionals to identify and adopt the best accounting policies in accordance with the specifics of the activity and legislative requirements.

IV. Monitoring and constant updating of accounting policies in accordance with legislative and technological developments. Understanding the impact of new technologies, such as blockchain or artificial intelligence, on accounting policies can bring significant advantages in the efficient management of the activity of economic entities.

These conclusions and recommendations should provide insight into the importance of improving accounting policies in order to effectively manage the activity of economic entities and can serve as a guide for future research and for financial-accounting professionals.

REFERENCES

- 24th Extract from the EECs's Database of Enforcement published at 02.04.2020. The European Securities and Markets Authority, 18 pages. Retrieved January 3, 2024 from: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-24th-extract-its-eeecs-database>
- Amarfii-Railean, N. (2020, October 9). Diagnosticul activității și poziției financiare a întreprinderilor agricole. Abordare macroeconomică. *"The relevance and quality of university education: skills for the present and the future": Materials of the International Scientific Conference, dedicated to the 75th anniversary of the founding of the University of Bălți*, 1, 277-284.
- Atkinson, A. A., Kaplan, R. S., Matsumura, E. M., & Young, S. M. (2021). *Management Accounting: Information for Decision-Making and Strategy Execution*. Pearson, New Jersey.
- Bădicu, G., & Mihaila, S. (2014). Accounting policies: basic principles and qualitative characteristics of information. *Economica*, 90(4), 80-86.
- Bellucci, M., & Liberatore, G. (2019). The importance of accounting policy choices for financial statement comparability: Evidence from Italy. *Journal of Applied Accounting Research*, 20(3), 358-374.
- Cazacu, A., & Caraiman, I. C. (2018). Financial performance evaluation in the context of IFRS adoption: Evidence from Romanian companies. *European Journal of Accounting, Auditing and Finance Research*, 6(2), 1-14.
- Cobzari, L., Paladi, V., & Erhan, L. (2015). Poziția și performanța financiară a entității prin prisma noilor reglementări. *The international scientific conference "Competitiveness and innovation in the knowledge economy"*, 2, 6-10.
- Dascălu, R. (2020). De ce este necesar manualul de politici și proceduri contabile, obligatoriu în România? Retrieved January 5, 2024 from: <https://accace.ro/de-ce-este-necesar-manualul-de-politici-si-proceduri-contabile-obligatoriu-in-romania/>
- Dănuțiu, A. (2018). IFRS application in the European Union—challenges and opportunities. *Financial Audit Journal*, 16(4), 6-9.
- De George, E. T. (2015). The importance of accounting policy choice in the measurement of earnings: An examination of discontinued operations reporting. *Accounting Horizons Journal*, 29(2), 247-264.
- Dima, S. I. & Dima, B. (2017). The impact of IFRS adoption on financial ratios: Evidence from listed Romanian companies. *Economic Computation and Economic Cybernetics Studies and Research*, 51(1), 5-21.
- Gaber, M. M. (2020). The impact of accounting policy on the quality of financial reporting in the UAE. *Journal of Financial Reporting and Accounting*, 18(1), 62-80.
- Grosu, V. (2020). *Perspective și limite în procesul de armonizare financiar-contabilă*. TipoMoldova, Iași.
- Kimmel, P. D., Weygandt, J. J., & Kieso, D. E. (2021). *Financial Accounting: Tools for Business Decision Making*. Wiley, New Jersey.

15. International Accounting Standards (IAS 1, IAS 8, IAS 10). Retrieved January 10, 2024 from: <https://mf.gov.md/ro/content/standardele-interna%C8%9Bionale-de-raportare-financiar%C4%83-2017-red-book>
16. Mykhayliv, D., Nadochey, Y. & Shmatko, N. (2020). Accounting policy choice and earnings management in Ukraine: Evidence from listed companies. *Accounting and Finance Research*, 9(1), 192-202.
17. Socoliuc, M., & Grosu, V. (2015). Financial instruments evaluation and the difficulties of economic and financial communication. *Annals of "Constantin Brancusi" University of Targu-Jiu. Economy Series*, 2, 226-230.
18. Tişcenco, V., & Bădicu, G. (2022, March 11-12). Politicile contabile - instrument relevant în asigurarea coerenței și stabilității entității / Accounting policies - relevant instrument to ensure the entity's coherence and stability. *The international student scientific conference (ISSC 2022) "Accounting challenges in the view of young researchers"*, 6, 80-89. <https://doi.org/10.5281/zenodo.6700655>
19. Trivellas, P., & Trivellas, A. (2018). The importance of accounting policies for a fair and transparent reporting of entities' performance. *The Journal of Accounting and Management*, 8(1), 19-38.
20. Бурсулая, Т. Д. (2020). *Maintaining accounting accounting of sources of formation of property of the organization*. Phoenix, Rostov-on-Don.