

## ASSESSMENT AND RECOGNITION OF STOCKS IN ACCOUNTING ACCORDING TO INTERNATIONAL STANDARD OF FINANCIAL REPORT IAS 2 – STOCKS

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### Abstract

*In life accounts of an enterprise stocks represent a very important topic in the light of their cost reflected in the profit and loss account on the one hand, and the value of assets shown in the balance sheet on the other hand. In practice are met two categories of enterprises for which stock accounting are very important.*

*The first category is represented by commodities traders, who have typically a single class of stock: goods. In this case the trader buys stocks for the purpose of resale. The second category is the producers of goods, which usually meet three categories of stocks: the raw materials, progress production and finished products.*

*It is obviously that the assimilation process of accountancy standards culture will have repercussions on medium and short term over the management controlling system, and over the informational system, in forthwith time. The informational system, understood as an assembly of technical means and human resources, of methodologies and procedures, of data collected and finally of information, which will have to be proper with a view to draw up a balance in accordance to the new accountancy rules.*

*These changes will be especially of technical-accountancy nature and will foresee: the accounts plan, the connections between different drawing up and collecting of data systems, the financial reports and the disclosure and reclassifying procedures*

**Key words:** evaluation, recognition, IAS/IFRS, stocks, financial statements

**JEL Classification:** M 43

## INTRODUCTION

Accounting for stock is offered by IAS 2 – *Stocks*. The standard provides guidance on the recognition of the value of stocks at the balance sheet date, the cost of inventory and recognition of expenses for stock, considering any record net realizable value. [1]

Also, standard provides guidance on the practical procedures for determining the cost of stocks.

Related to stocks accounting, both dealer, and manufacturer, should answer to the following questions:

- Under what conditions an entity must recognize stocks in its assets?
- At what value is stocks evaluated at the entrance in entity and which costs that the entity is employing must be included in the cost of stock?
- When stocks are recognized as expense and which are the formulas for determining the cost? [3]
- At what value stocks are recognized in the balance sheet?[2]
- What information should be presented in the annual accounts?

IAS 2 applies to accounting of all stocks reflected in financial statements prepared on the historical cost, except:

- progress production obtained in the construction contracts, including those of services directly related to them (IAS 11 - *Construction Contracts*);
- financial instruments (IAS 39 - *Financial Instruments: Recognition and Measurement*);
- stocks of agricultural products, forestry, minerals belonging to producers when are valued at the net achievable rate, based on the specific practices of each sector separately.

## DEFINITIONS, DEMARCATIONS AND STRUCTURES REGARDING STOCK

The international reference defines stocks as assets:

- held to be sold during the normal conduct of business;
- under production to be sold in subsequent periods;
- in the form of raw materials and consumable materials, used for production of goods or for

services.

This separation of stocks does not take into account the nature of the item, but the destination of the company who owns the property. Also, the standard does not specify an upper limit value or a maximum duration of use.

### Example:

An entity can buy apartments in order to resell them. In most cases, the apartments are purchased by an entity for rent or to use for administrative purposes. In this case they will be classified as fixed assets. If the aim is to resell them, the apartments will be classified as current assets (stocks).

Moreover, we meet situations where stocks are devoid of a natural substance (a kind immaterial), such as services and un-invoiced.

The definition puts in evidence three criteria according to which they are classified and defined in financial accounts *physical condition, the destination and the cycle phase of operation* .

If is taken into account the physical condition of the stocks, are individualized following structures:  
[7]

- *goods*, namely goods which the entity buys them for the purpose of resale or products delivered to own stores for selling;
- *raw materials* which directly participate in production and are found in the finished product integrally or part, either in their original or converted shape;
- *materials* (auxiliary materials, fuel, packaging materials, spare parts, seeds and planting materials, animal feed and other consumables), which participate in or help to the manufacturing process or operating without a trace, usually in the finished product;
- *materials of the objects inventory nature*;
- *products* as semi products, finished products, scrap, waste and recoverable materials;
- *young animals*, animals fattened, birds and colonies of bees;
- *packaging*, including reusable packaging, purchased or manufactured, destined to sold products and which temporary can be kept by others, with the refund obligation as stipulated in contracts;
- *running production*, representing the production which has not gone through all phases (stages) of processing, provided in technological process, and products not given tests and technical receipt or entirely not completed. Within the running production includes, a Iso, works and services, and ongoing execution or unfinished.

If is taken into account the destination, stocks can be defined as:

- stocks for achieving the activity object of which is found in products manufactured or services: stocks of raw materials and materials supplies;
- stocks manufactured in the company stock and for sale: semiproducts, finished products;
- Stocks in running production (WIP);
- stocks bought for the purpose of resale: goods, real estate properties for resale.

Depending on the phase of exploitation cycle, stocks are off the following structures:

- Stocks in phase supply;
- stocks in production stage;

- Stocks in stage of outlets.

## NATIONAL APPROACH

National stocks take over the definition from the international reference. Unlike IAS 2, the national accounting rules that have more of a role of regulation, than to lay down principles, explicitly details the categories of stocks, and their way of accounting. [6]

Within an enterprise, are individualised two basic informational structures on stocks: a standardized financial structure (built by the chart of accounts) and a management structure.[5]

*Standardized financial structure* is part of financial accounting and is done with the help of accounts of the General Plan. In the financial accounts of the company stocks are defined and classified according to four criteria: physical, destination, phase cycle of exploitation and the creation of management.[4] Compared with the three criteria for classification and delineation of the stocks found in the definition of IAS 2, we observe that national regulations operate with a fourth criterion and, namely the place of creation of management. In relation to this criterion stocks are grouped into:

- Stocks in locations of the enterprise;
- stocks on third parties;
- stocks received in custody, for processing, etc..;
- stocks delivered, but un-invoiced;
- stocks charged, but not delivered.

*Internal or management structure* is one non-standard and is specific to management accounting. It operates with the analytical accounts appropriate to the range of stocks and stock management.

## RECOGNIZING STOCKS

### INTERNATIONAL APPROACH

#### Example:

In the case of stocks, the potential to contribute to cash flow to the company, is one productive, belonging to current activities (operational).

Usually, stocks are used by the enterprise for the production of goods and services to satisfy customer needs. That is way customers are willing to pay to purchase these goods, and cash came from the stock sale or provision of services gives the company an advantage, because it allows the control of other resources.

The second criterion for recognition of stock, is the credibility of the assessment. The assessment, in itself, should not cause a problem, since the entry into the unit, stock element is clearly identified. If however, the stock value should be expected, this fact did not affect the credibility of accounting information related to the cost of stock. [9]

However, there may be some situations and conditions in which recognition of stock may raise some problems. It is the case of immaterial stocks and stocks for which can not be proved generation of future economic benefits attached to them.

#### Example:

1. Within the activity process the enterprise is supplying with items that can not be stocked or utilities (electricity and heat, water, etc.). In these circumstances it is unlikely that these elements to generate future economic benefits and to be recognized in the balance sheet as current assets and will be recognized as expenses in the period.

2. There are situations in which companies will recognize as stocks and items that lack

physical substance. Is the case of running works and services wich will be classified as stock in the balance sheet.

Another issue raised by the stock recognition of that related to associated legal rights, primarily of ownership. IASB Framework does not make the recognition in the balance sheet of an asset of ownership associated with it.

Ownership is not always essential for determining the existence of an active, if the entity does not control the economic benefits generated by the property in question. In such cases, in which the legal form of transactions do not reflect economic substance, must be applied the principle *sostanza sulla forma* for recognition of stocks. [8]

**Example:**

There are situations where one entity owns the stocks in the consignment. Legal status of these stocks is governed by contractual provisions. If from the consignment contract results that the owner of goods has transferred the risks and benefits associated with stock, then the entity that has stocks may recognize them in its assets (it has the ability to control the economic benefits). Examples of contractual clauses which, taken together, transfer the risks and benefits on stocks:

- stocks are held by a receiver an agreed period of time;
- are returned in case of not-selling in the state in which they were received;
- receiver due to interest payments and compensation for stocks that were not sold during the period covered by the contract.

## NATIONAL APPROACH

National regulations classify stocks as current assets. For the meaning of the current regulations an asset is classified as current assets if: [12] -[13]

- is purchased or produced for own consumption or for sale and is expected to be completed within 12 months from the balance sheet date;
- is represented by debt related to exploitation cycle;
- is represented by treasury or treasury equivalent whose trade is restricted.

By operating cycle is understood the period of time from the purchase of raw materials entering into a process of transformation and complete them in treasury or equivalent of treasury.

Synthesizing, the items are recognized in the balance sheet as stock, if:

- meet the conditions for recognition of assets;
- are purchased or produced for own consumption or for sale;
- is expected to be completed within 12 months from the balance sheet date.

For recognition of an item as a stock, we see that is not important its nature, but the *purpose* for which it is intended and lasting achievement. Also there is no reference to an upper value limit depending on which to make the delineation from other assets (compared to fixed assets for example).[10] –[11]

**Example:**

An enterprise specialized in metal processing, purchases two lathes. A lathe is purchased for use in the production, and the second lathe to sell to a subsidiary in Italy. Accounting treatment of the two lathes is as follows:

- lathe purchased to be used for productive purposes is classified by the entrepreneur as fixed assets. The purpose of purchase was to use it on a continuous basis, a longer period (over one year);
- lathe purchased for resale, is classified by the entrepreneur as a stock item (commodity). Although the goods are similar, because of different purpose that entity gives it, they will be

accounted differently.

## CONCLUSIONS

General framework for the preparation and presentation of financial situations of IASB defines the recognition as the process of incorporation into the balance sheet or in the account of profit and losses of an item that meets the criteria for recognition.

As assets, stocks are recognized in the criteria within are met criteria for the recognition of assets and, namely: is likely that any future economic benefit associated to enter or come in or out of the enterprise; the item has a cost or value that can be evaluated credibly.

The first criterion refers to the uncertainty degree in achievement of future benefits related to stocks, in our case. To evaluate the degree of uncertainty must be taken into account available information at the time of recognition.

Future economic benefits associated with stocks are the potential to contribute directly or indirectly to the flow of cash and cash equivalent to the enterprise. In this article has been approached the subject of reassessing the tangible assets, emphasizing on the two methods for managing the amortization on the reassessment date. After analyzing the examples supplied it is noticed that both methods generate the same amortizable value after reassessment. No matter if one method or the other will be chosen, the economic entity will have to supply, in its financial statements, the following information: date when the reassessment will enter in force, whether the entity employed an independent assessor, the significant methods and assessments applied for estimating the honest value of the elements, the reassessment excess, thus identifying the modifying corresponding to the period of time and the limitations as regards distributing it to the shareholders. For each reassessed category of tangible assets it is necessary to mention the accountancy value that would be obtained if the cost model would be applied.

We must take into account that improving a company's performances involves the operative and as exact as possible measuring the efforts and the effects, as well as efficiently using the tangible assets. Organizing and leading the accountancy management of the tangible assets relies more and more on careful researching the structure and dynamics elements, but especially on decoding the evolution tendencies of the phenomena that occur in the company and in its external environment. An economic entity will be able to change its accountancy option as regards the tangible assets' elements only if it will prove that the new option will have an important effect in the current period of time or in the next periods. The main effect of adopting the new option must be more accurately and more authentically presenting the tangible assets in the financial statements.

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