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The Impact Of Accounting Estimates On Financial Position And Business Performance – Case Of Non-Current Intangible And Tangible Assets

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Abstract

Financial statements represent a great source of information for company's financial position and business performance evaluation. Management judgment depends on the information base which is given at the time of judgement. Each judgement is by its nature subjective, so the results of the estimation can differ. Non-current tangible and intangible assets represent a significant proportion of assets of many companies. There is a plenty of space for applying accounting estimates in order to recognise and measure such assets. The research model confirmed the volatility of financial condition and performance of a company as a result of different accounting estimates.

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Keywords: accounting estimates; business performance; financial position; intangible assets; tangible assets

1. Introduction

''*Making good decisions and making them happen quickly are the hallmarks of high-performing organizations*'' (Rogers and Blenko, 2006). Numerous strategic, tactical and operational decisions should be based on quality information. Therefore, objective and reliable accounting information is a prerequisite for proper decision making processes. Since financial statements portray financial position and business performance of a company they are an

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inevitable source for decision making process. Items represented in financial statements should be measured by applying international or national financial reporting standards. Accounting principles for evaluation of those items are well known and dependent on historical or fair value. However, depending on the method of the evaluation, the item is more or less a subject of estimates. Even International Accounting Standards Board (IASB), as the International Financial Reporting Standards' standard-setter, admits that *''to a large extent, financial reports are based on estimates, judgements and models rather than being exact depictions''* (International Financial Reporting Standards Foundation, 2015). Making estimates implies a certain level of subjectivity. Two different estimates for an item can result with different accounting information. As a consequence, the financial health and performance of a company will vary; so can financial statements users' business decisions. The fact that many audit firms express adverse inspection regarding accounting estimates applied by companies (KPMG, 2015) confirms that accounting estimates are a top issue in the accounting profession. In addition, SEC has emphasized the importance of disclosures regarding critical accounting estimates (KPMG, 2015).

Non-current tangible and intangible assets represent a significant proportion of assets of many companies. Consequently, there is a plenty of space for applying accounting estimates in order to recognize and measure such assets. Taking into consideration the stated problem, the main research goals are: to differentiate accounting policies from accounting estimates, find out critical areas for management judgments of non-current intangible and tangible assets, design and apply the model for empirical testing of accounting estimates' influence on financial statements, discuss research findings and form research conclusions. The purpose of the study is to indicate the most sensitive areas of accounting estimates of non-current intangible and tangible assets and to emphasize the importance of disclosed information of accounting estimates for financial statements analysis of a company. Further, the goal of the study is to design the model for non-current intangible and tangible assets estimates testing and to draw a conclusion about the impact of accounting estimates on business security and performance.

2. Theoretical background

2.1. IFRS as a framework for accounting estimates

Making accounting estimates is a very complex process that connotes obtaining of all required information about the topic, understanding different accounting estimates' alternatives resulting from accounting standards and national laws, recognising the consequences of such alternatives and identifying the need of judgment's reassessment in the future. Accounting estimates can be observed from different party's point of view. First of all, standard-setters think on accounting estimates when developing accounting standards. They should ''*create standards which allow judgement within a principles-based framework*'' (ICAS, 2012). Next is a judgement in accounting where management make accounting estimates while accountants record business events resulting from such estimates in accounting evidence. There is also an auditor's view of estimates. Auditors should assess its client's accounting estimates when performing the audit of financial statements and forming an opinion about them. Finally, many regulators and other financial statements' users will be interested in information about applied accounting estimates. The Institute of Chartered Accountants of Scotland (ICAS, 2006) explains the Diamond of Trust between standard-setters, preparers, auditors, regulators and other users where all the mentioned parties should allow management to exercise judgement in presenting economic reality of business events.

In all cases, accounting standards represent an important source of accounting estimates. Since International Financial Reporting Standards are global accounting standards with more than 140 individual jurisdictional applications, while many national accounting standards converge with IFRS too, the paper considers IFRS as the most important regulatory framework for accounting estimates. The *Conceptual Framework for Financial Reporting* (IASB, 2010), as a part of IFRS, *''establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive.''* The IFRS Framework understands relevance and faithful representation as fundamental qualitative characteristics in order to be useful for its users. The relevance of financial information can be affected by the level of measurement uncertainty that, according to the Framework, arises when an asset or a liability cannot be measured directly so must instead be estimated. According to the IASB (IASB, 2010) "*an estimate can provide relevant information, even if the estimate is subject to a high level of measurement uncertainty. Nevertheless, if measurement uncertainty is high, an estimate*