

**UNIVERSITY OF CRAIOVA**  
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# **DOCTORAL THESIS**

**- ABSTRACT -**

**POLICIES AND ACCOUNTING TREATMENTS  
FOR THE EVALUATION AND MANAGEMENT  
OF FINANCIAL INSTRUMENTS**

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## ABSTRACT

The development of a Romanian economy able to adapt to the current competitiveness imposed by the globalization can not be achieved without an efficient activity of the capital market. Through its specific mechanisms, the capital market mobilizes and concentrates capitals and provides the instruments needed to exploit investment and hedge the risks.

Expansion of international cooperation and exchanges of values generated an increasing circulation of financial flows and changes in the architecture of capital markets. Progressive abolition of restrictions on capital circulation in the case of economic entities has increased the possibilities of attracting funding sources, both on local and international capital markets. The listing of entities on different capital markets generated the diversification of their portfolio and maximization of profits, while reducing the risks associated with equity investments. In recent decades, there is a greater variety and complexity of financial instruments, a fact that has caused difficulties in the supervision and regulation of global financial market.

Thus, the trend of globalization and its economic consequences, as well as the growing need to inform investors who place their equity, left their mark on the accounting profession, because of the need for a higher level of transparency in financial reporting by applying general principles on the information that must be presented to all market participants. Identification of the principles adequate for the accounting of financial instruments is not an easy task, since it is often difficult to extract the economic essence from the financial engineering developed by experts in finance.

In this permanently transforming context of global transactions, the ability to apply a sound judgment in assessing the performance and financial position of an entity becomes a must for any professional in accounting. In the era of multinational accounting and business cycles, the most important factors are the use of financial instruments for hedging and the current position of the entity's liquidity. The result of an enterprise depends not only on economic and financial performance, but also on the accounting methods chosen. Under these conditions, improving accounting in general and Romanian accounting in particular is a natural process. Evolution of the accounting system has made estimates and professional judgment increasingly important in decision making. An efficient accounting system will treat the risks, both exhaustively and systematically.

Because any area of research needs to determine its own path of progress and define their own conceptual cues, ***the motivation and importance of this research*** may be found in one of the priorities of economic research, namely the reevaluation of financial instruments' accounting, which is a dynamic field.

Comparability of financial statements elaborated and presented by the economic entities operating in the capital market has been a constant concern of the accounting profession worldwide, the central pivot being the International Accounting Standards Board (IASB). IASB focused on reducing the differences

existing in presentation of financial information, by harmonizing the accounting regulations, standards and procedures relating to financial instruments in order to provide useful information to economic decision-making process.

A number of projects to create standards on accounting for financial instruments have been initiated in the USA ( by the Financial Accounting Standard Board in developing US-GAAP), where there was a significant demand for the financial instruments' accounting at fair value, in order to obtain a true reflection of the risks and rewards implied by the ownership of such instruments. Moreover, the starting point in initiating regulations on financial instruments in Europe was the American accounting referential, whose development in the field was imposed by the level and complexity of transactions made on the American capital market.

Since 2000, FASB and IASB have sought to eliminate differences between U.S. GAAP and IFRS, a process called "convergence". Currently, international accounting referential in the field of financial instruments is using three standards:

- IAS 32 Financial instruments: Presentation
- IAS 39 Financial instruments: Recognition and Measurement;
- IFRS 7 Financial instruments: Disclosures.

These standards had a complex evolution, which led to the extremely complicated current standards, which are difficult to implement and at the same time controversial. The multiple changes are the expression of traditional accounting's transformation from an accounting based on the principle of historical cost in one based on fair value. There are opinions according to which, in time, a switch was made from the principle-based approach towards one based mainly on rules.

We believe that the convergence and harmonization of international accounting and the elaboration of a common language used globally bring along significant benefits for the global economy.

At EU level, the process of harmonization and compliance has to overcome at least three obstacles:

- differences in the regulation of accounting in each Member State;
- differences in the interpretation of concept of true and fair view by each country;
- links that interconnect the tax system and accounting in each country.

Despite these difficulties and the particularities of each country, EU Member States have embarked on the harmonization and compliance of accounting, realizing the advantages of this process. Our country has engaged in this extensive process, national accounting being subject to a complex process of reform in the last decade.

***The subject of this study is motivated*** primarily by the fact that financial instruments research must be placed in the current economic context and, secondly, by the need to renew and improve the techniques of evaluation and management of financial instruments in order to better reflects the results of an economic entity, according to the requirements of the stakeholders. Economic entity is like a living organism and its analysis should be made taking

into account the whole system. An economic entity is a dynamic environment whose main objective is to add value. All the above mentioned aspects ***justify the importance of this study on the evaluation and management of financial instruments.***

Issues of management and evaluation of financial instruments have generated numerous debates and controversial discussions and was the subject of numerous studies and researches conducted both by professionals and accounting regulatory institutions or capital markets.

Considering the stock market in our country is continuously growing and increasingly more Romanian companies use financial instruments to obtain the necessary resources, but also to protect themselves against various risks they are confronted to, we found interesting and useful to study this particularly complex field of the accounting of financial instruments, taking into account the spectacular developments on the global capital markets in the last decades.

**The major objective of our research** is to analyze how the evaluation and management of financial instruments is done, their accounting and in which degree does the information released in the financial statements of an economic entity meet the needs of users to anticipate future developments of these entities.

**Scientific significance and practical value** of the PhD thesis consists of the current and complex problems studied, oriented towards policies and accounting treatments applicable to financial instruments. Theoretically, this paper will contribute to increasing the knowledge on financial instruments and the modalities for their recognition and non-recognition in the financial statements of entities, as well as to better understand the notions and concepts contained in the accounting standards on financial instruments. The thesis can be an important theoretical and practical support due to the numerous case studies presented, on both the rules of evaluation and recognition of primary and derivative financial instruments and the application of hedge accounting operations.

**Relevance of the topic studied** in this paper is closely related to its future potential contribution to advancing the state of knowledge in the domain addressed in the research.

Demarcation of research has been determined by factors such as:

- central theme of the paper, namely evaluation of financial instruments;
- the need for international standards on accounting for financial instruments;

**The importance of this scientific approach can be justified at least by the following arguments:**

- it contributes to the development of knowledge in accounting and finance, with implications for the performance management in an economic entity;
- it contributes to acknowledging the stages that have marked the evolution of international accounting regulations of financial instruments and the harmonization and compliance process the Romanian accounting system is undergoing;

- it provides a detailed analysis of the treatment of financial instruments, considering the context of accounting regulation and potential influencing factors;

- it highlights the conceptual delimitation between financial assets, financial liabilities and equity instruments, a subject still debated and poorly clarified by the accounting regulatory bodies;

- it presents the main provisions of international accounting referential on the recognition, non-recognition and measurement of financial instruments, and on hedge accounting, with reference to accounting practices and opinions in the specialized literature;

- it presents and analyzes the dimensions of global performance, emphasizing the measurements of performance by which analysts can assess the overall performance of economic entities listed on the capital market;

- it conducts an empirical research that led to the construction of a mathematical regression model that demonstrates the dependence of the volume of SIF 5 securities' transactions on certain economic indicators.

Given the importance and complexity of the issues addressed, PhD thesis titled "ACCOUNTING POLICIES AND TREATMENTS FOR THE EVALUATION AND MANAGEMENT OF FINANCIAL INSTRUMENTS" was structured in four chapters, in order to present in a logical succession the methodologies, methods and procedures related to the evaluation, management and accounting of financial instruments, combining knowledge from the field of accounting, finance and applied mathematics. Secondary objectives are subsequent to the main objective and will be presented in detail on chapters in the following paragraphs.

The first chapter entitled "**Theoretical and methodological aspects on financial instruments**" is devoted to the theoretical presentation of all aspects related to financial instruments. In the *first part* of the chapter, focus was put on the capital market, the environment of financial instruments, by analyzing the evolution and development of the national capital market in a changing global financial economy.

The second chapter entitled "**Accounting convergence, harmonization and compliance regarding the recognition and evaluation of financial instruments**" highlights the analysis of accounting regulatory process in the case of financial instruments. Once identified the trends over time in the regulatory process of accounting, some concerns existing at international and national level have been identified, marking the first initiatives in this area, as well as the further development of accounting standards on the recognition and measurement of financial instruments. The second part of the chapter is devoted to presenting, analyzing and implementing the main provisions of accounting standards, referring to the criteria for recognition and derecognition of financial assets and financial liabilities. After presenting the concept of initial recognition formulated in the literature, we drew attention to the different methods used to recognize financial assets and financial liabilities on the balance sheet. We pointed out that, in accordance with accounting legislation in our country, a financial asset can be presented in the financial statements of an entity, both in fixed assets (financial assets) and in the current assets (short-term investments,



availability). Classification of financial liabilities can be done both among the current liabilities and in the long-term debt. In the second part of this chapter, we drew attention to the operation of derecognition, that operation of removal from the balance sheet of a financial asset, financial liability or part thereof.

The third chapter entitled "**Accounting treatments for financial instruments**" was divided into two parts, given that financial instruments, based on the method of evaluation, are used either for making profits and hedging. The first part deals with the accounting of primary financial instruments, having regard to the three categories of financial assets: securities held for trading, securities available for sale and investment securities held to maturity. The second part of the chapter aims to present the hedge accounting, both theoretically and practically. The need to develop an accounting of hedging transactions derived from the emergence of imbalances (inconsistencies) in the assessment and recognition of derivatives. In the case of evaluation, accounting discrepancies are arising from the fact that certain financial instruments are not measured at fair value, while all derivatives used in hedging transactions are measured at fair value.

In chapter four of the PhD thesis entitled "**Analysis of securities transactions' influence on the performance of listed companies**" we have considered appropriate to analyze the concept of performance and the indicators used to assess performance in the context of international accounting rules. We conducted in this regard a case study on the performance of Financial Investment Company Oltenia SA, ending with a mathematical regression model that demonstrates the impact of the main stock exchange indicators on the volume of securities transactions. We chose to analyze this company, given that the development of capital market in our country is strongly correlated with the evolution of financial investment companies.

The paper concludes with a summary of the main general **conclusions** drawn from the research made, which allowed the formulation of some opinions on the need, possibilities and perspectives of evaluation and management of financial instruments.

The elaboration of the PhD thesis involved following a few guidelines on the methodology of scientific research, which we highlight below. One of them refers to the observance of some specific principles and rules. Throughout the research paper we have tried to respect *the principle of theoretical and empirical unity*. Any empirical approach must be anchored in theory, to which we have granted consistently space throughout each chapter. Another principle we followed in developing this study was the *principle of unity between observant and evaluative judgments* since any researcher must morally commit to supporting generally valid values.

Regarding the **working methods** for the collection and interpretation of data, the most commonly used method of research was *the comparative method*; we have used it in addressing both theoretical and empirical issues of our research. We also used *longitudinal methods* in each chapter by presenting the evolution in time of the concepts discussed in the paper. Another method used is the *constructive method*, meaning the analysis of concepts to highlight the

advantages and limits of their use in order to determine the need to maintain or abandon them. Especially in the first three chapters (the theory of our research), we used *the non-participative observation method* by presenting various theoretical aspects, and it may be noted that, at the end of each chapter and subchapter, we also used the *participative observation method*, by drawing partial some conclusions.

**The methodological and theoretical support of this research** was the classical and modern theory on the activity of financial markets, some fundamental books in this field of researchers and professional bodies, as well as various publications and foreign periodical literature. A great part of the research work has been focused on research, using all available national, European and international literature, the documentary sources being the most diverse, from legislation, articles published in various journals, reports, guides, manuals, monographs to information published on the Internet. Documentation and data collection was complemented by observations in practice and data archives, which provided control over the information analyzed and used in our research.