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THE PREVALENCE OF SUBSTANCE OVER FORM AS AN ATTRIBUTE OF THE CREDIBILITY OF ACCOUNTING INFORMATION

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Abstract

In order to be useful, accounting information should be credible. Information is credible only when it is free of significant errors and it is not biased. The ingredients which make information credible are: true to reality representations, neutrality, caution, integrality, and the prevalence of the economic over the legal. To ensure accounting information credibility, transactions must be presented consistently with the economic substance, not only with their legal form.

In order to be useful for users, accounting information has to have certain qualities. The general IASB guidelines for preparing and presenting financial situations describe four main qualities: intelligibility, relevance, credibility, and comparableness.

Intelligibility refers to the easy and immediate understanding [1] of information by the users. The large diversity of users of accounting information has determined the reporting entities to offer clear information, capable in helping users to make decisions. Thus, there must be a balance between accounting knowledge on one hand, and users' desire to understand the information with reasonable effort, on the other hand. However, information should not be excluded from financial situations, when it is relevant, only because it could be hard to understand for some categories of users.

Relevance. Information present in financial situations is relevant when it influences the economical decisions of users, helping them to evaluate past and present events, and to use them as a basis for predicting future financial situations, confirming and correcting previous evaluations. The ingredients [3] of a relevant representation are the predictive qualities, the retrospective value, and the relative availability and importance.

In order to have predictive value, information has to take the form of an explicit forecast. The efficiency of prediction depends on the quality of the information from past transactions and events. The future can be perceived in terms of certainty and uncertainty, and from this point of view, we can either consider the firm's future to be certain, associating it with a single prediction, or we can consider it in terms of several possibilities, associating it with multiple predictions. The clarity of the prediction, which is based on information about the past, depends on the adequate reflection of the evolution of the firm through a model built on historical data.

Information relevance is influenced by its nature and materiality. In most cases, nature is sufficient by itself to determine the relevance of information. In other cases, nature itself is not sufficient for the information to be relevant, and it is necessary to associate it with its materiality or significance. Information is significant [2] if omitting it or erroneously presenting it could influence users' economical decisions in this form.

Materiality refers to the significance threshold of information, which depends on the size of the element or of the error, judged in the specific context of the omission or the erroneous presentation. Thus, the significance threshold offers more a quantitative criterion[4] (a limit, a ceiling) than a qualitative one, which the information should adhere to in order to be usable.

Comparability. In order to compare financial situations in time and space, information has to be comparable. To ensure information comparability, the organization has to make its methods permanent. If the methods have changed, the users have to have the resources to identify the differences between the different accounting methods.

The need for comparability should not become a barrier in introducing improved accounting standards, only because this way, there would be a lack of homogeneity in information.

Credibility. Accounting information is credible when it is free of significant errors[5], it is not biased, and the users can confidently believe that it represents what it was meant to represent.

Credibility is defined by the following elements, in random order of importance: a representation that is true to reality, neutrality, caution, integrity, and the prevalence of the economical over the legal.

The neutrality of the information is insured when the information is free of distortion and does not influence decision making in a predetermined direction.

Caution[6] means including some precaution in estimating judgments in uncertainty conditions, such that the assets and incomes are not overestimated, and the debts and expenditures are not be underestimated.

Integrality assumes that the financial situation information is complete, within reasonable thresholds of significance and of costs of obtaining that information. There may be omissions, either as false information, or as a way to bias the economic decision of the user.

If neutrality, caution, and integrality were presented separately, the prevalence of the economic over the legal and the representation true to reality should be presented in their interaction, because accepting or not accepting economy's priority over the legal viewpoint leads to a different interpretation of the concept of a true image[7].

The true to reality image, as a fundamental goal in European accounting, is a concept which originated in Great Britain, and it was first formulated in the law of British commercial associations in 1974. Later, it borrowed and defined in the Fourth Directive of the European Economical Community[8]

The concept of true image was the object of a large dispute between two major accounting schools, the Continental-European School, and the Anglo-Saxon School, and it remains an important obstacle in creating internationally homogeneous regulations. The international accounting referential[9] does not directly define the concept of true image. The ideas related to this have more of a general character, such as: the information presented in the balance sheet must be a true representation of the transactions and other events that it is meant to represent, or the application by accounting of the adequate standards and quality criteria will result in creating a financial situation which generally reflects a *true to reality and just image*.

The true image as an accounting dimension[10] is hard to define, and this led to a variety of interpretations, of which two are most relevant: the Anglo-Saxon and the Continental-European.

In the Anglo-Saxon interpretation, the concept of true image is defined through the prevalence of the economic over the legal. According to this viewpoint, the transactions and events are presented in an honest manner if they reflect their economical substance.

The substance of a transaction or event is not always in accord with its legal form. However, for most transactions, their legal form and their economical substance will be one and the same, since contracts are prepared to reflect the economic effect of the transaction. However, in some cases, the real commercial effect is not expressed in credible terms through the legal form of the transaction. In these cases, in order to present credible information, substance should come before form.

In the Anglo-Saxon accounting literature, the concept of true image is best described by the expression "*true and fair view*". One view of truth in accounting is presented by M. Ristea and C.G. Dumitru in their paper "Advanced Accounting." [11]

The authors show that the truth, in its true image meaning, reflects the ability and the obligation of financial situations to provide real and correct information about the financial situation and the outcomes of an organization. The accounting truth defined in this manner is a reflection of both a *reflective truth*, which reflects reality just like in a mirror, and a *constructive truth*, which provides processed information.

The reflective truth reflects the relationship between the object and its representation. The observation and reflection of the object has to meet certain standards of a true image. To fulfill this, the documents used for incoming information have to contain real and correct data, and the person preparing these documents has to be trustworthy.

The constructive truth reflects the fact that the accounting information is produced in accordance with standards and ethical principles accepted and used as a reference. In these conditions, the reality is reflected by accounting information obtained after processing using a certain algorithm.

The Anglo-Saxon perception of the concept of true image for producers and users of accounting information seeks to respect accounting standards, which places the constructive truth in this perception area, while the reflective truth based on regularity and honesty is a better fit with the Continental-European viewpoint.

In the Continental-European accounting, the prevalence of economical substance over the legal aspects is not obligatory to define the true image. In a form of accounting governed by legal norms, the true image, as a goal of financial accounting, is defined through terms such as regularity and honesty.

Regularity means respecting the current accounting rules and procedures. To assess the extent to which one respects those rules, legal texts are used and they are applied hierarchically.

By applying accounting norms there can be situations which are in conflict with the true image. Some of these situations are:

- The emergence of a conflict situation between evaluation rules consistent with the generally accepted principles and those imposed by the fiscal law. In those situations when the fiscal law does not ask for accounting registrations, this dilemma can be solved by registering it in conformity with the already accepted accounting rules and the application of the fiscal treatment in extraacounting manner. When the fiscal rule asks for registering the fiscal evaluation, the dilemma can be solved by creating special accounts.
- The existence of a situation when the accounting norms offer the organization the choice between several accounting policies. In this case, choosing the policies must be done in concordance with the other accounting principles which lead to a true image
- The existence of a situation in which the application of accounting norms would lead to an inaccurate image of the economical reality of the carried actions. In this case, in order to have an accurate reflection of the accounting operations, one must acknowledge the prevalence of the economical substance over the juridical form. Thus, we can conclude that in order to insure the true image, one needs to remember and use the principle

of prevalence of the economical over the juridical, only in the case of inaccurate information as a result of applying the juridical norm.

Honesty involves professionally and faithfully applying the accounting norms and regulations. Translating honesty into practice is helped by both the quality of the helping documents and through the professional behavior of the accountant.

Based on the discussion above, we can conclude that, in order to offer accurate information, it is necessary that the preparer of the financial situations emphasized the rights and obligations generated by the events and transactions that took place, which have a commercial effect in practice, thus reflecting the substance of the transaction or event.

Reference notes

[1] Immediate understanding does not refer only to the physical time allotted to understanding the information, but also that each and every one of the users can understand the information by him/herself, without the use of an interpreter.
[2] Feleaga N., Maliciu L. – Recunoastere, evaluare si estimare in contabilitatea internationala, Editura CECCAR 2004, op.cit., pp. 29.
[3] Feleaga N., Maliciu L. – Recunoastere, evaluare si estimare in contabilitatea internationala, Editura CECCAR 2004, op.cit., pp. 29
[4] The significance threshold as a quantitative criterion is used in financial auditing. The audit specialist, while auditing, establishes the signification threshold. The evaluation of significance thresholds as they relate to accounts and transactions helps the auditor to make decisions about some aspects such as issues that need to be analyzed and procedures that will be used.
[5] International Audit Standards define the term “error” as an unintended mistake which appeared in financial situations, such as: computational or accounting errors in registering information and data; overlooking or misinterpreting facts; the erroneous application of accounting policies. The evaluation of what exactly is significant is determined by professional logic.
[6] See the general IASB guidelines for presenting financial situations
Idea taken from A. Pop, Contabilitatea financiara romaneasca armonizata cu Directivele europene si [7] Standardele Internationale de Contabilitate, Ed. Intelcredo, 2002, pp. 25.
[8] M Ristea, C.G. Dumitru, Contabilitate aprofundata, Ed. Universitara 2003, pp. 19.
[9] IASB guidelines
[10] The true image is the supreme principle for the Anglo-Saxons, and it is the goal of financial accounting for most accounting systems of Western Continental Europe. In both cases though, more and more specialists consider “the true image as a convergence of all the other principles.” – this was formulated by A. Pop, Contabilitatea financiara romaneasca armonizata cu Directivele europene si Standardele Internationale de Contabilitate, Ed. Intelcredo, 2002, pp. 25.
[11] See M Ristea, C.G. Dumitru, Contabilitate aprofundata, Ed. Universitara 2003, pp. 19.

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3. M Ristea, C.G. Dumitru, Contabilitate aprofundata, Ed. Universitara 2003
4. The general IASB guidelines for presenting financial situations