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## The Concept of Low-Value in the Context of Fixed Assets<sup>1</sup>

**Abstract:** This article aims to present the possibilities of making simplifications to accounting, particularly in the recognition of fixed assets and other carrying value items, according to the principle of relevance and fair presentation. In order to achieve this aim, the authors used deductive and inductive research methods, such as a literature review, analyses of the content of financial statements, and statistical verifications of the findings.

Simplifications may be made to accounting provided that this does not distort a given entity's true financial picture, and thereby does not mislead the users of the financial statement; making it irrelevant. Establishing the levels at which some type of information should be deemed relevant is difficult but crucial in reporting and financial audit. The authors of the article propose a model to enable establishing the levels of relevance (with regard to both the financial statement as a whole and its components) in each economic entity, regardless of its size and industry in which it operates. This model was created based on the reporting data of Polish companies, constituting a correction of similar models applied in Western Europe. It facilitates the definition of an objectified level of partial relevance basically for all reporting items.

The authors used this model to research 148 companies by analysing their financial reports of 2007–2014, thereby reviewing the data of 1,184 financial statements, and other 337 smaller entities by analysing their financial reports of 2010–2017, thereby reviewing the data of 2,696 financial statements. In total, the authors analysed data from 3,880 financial statements. As a result, they drew conclusions as to the possibility of making simplifications in the recognition of fixed assets by entities. This research made it possible to establish the levels of relevance for the entities listed on WIG30, mWIG40, and sWIG80 as well as for the stock exchange companies not listed on any of the indices named, par-

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ticularly the partial relevance considered for depreciation (amortisation). The analysis of the research results, including the application of the Chi square test, has led to the question whether from the financial accounting point of view making one-off depreciations in the amounts of approx. PLN 10,000 (which the entities may want to practice in relation to the amendment to tax regulations) does not distort a given entity's financial picture in the view of its financial statement. The research hypothesis of the study assumes that not all entities maintaining accounting books may apply tax regulations in the field of recognition of low-value fixed assets. The analysis of the data contained in 3,880 financial statements of both larger and smaller entities has shown that the following research hypothesis should be adopted: not all entities maintaining accounting records may apply tax regulations for the recognition of low-value fixed assets.

**Keywords:** low-value, relevance, fair presentation, fixed assets, carrying value

**JEL:** M41

## 1. Introduction

Nowadays, the efforts are made to provide good quality economic information at almost each level of the activity of an enterprise, and the key criterion for measuring accounting quality is fair presentation of data in the general-purpose financial statement. It may be assumed that reliable information is the information free from errors and faithfully presenting the content to which it refers, which consequently presents a fair view – by means of actual accounting attributes – of the economic conditions and processes that constitute the object of measurement. What matters in the context of this development is that the ‘error-free’ information should not be associated with ‘perfect-in-every-respect’ information. Fair presentation should rather be defined as “getting close to the truth”: as a result, the accounting information that is reliable is not such because it is one hundred percent true, but because, having considered all objective cognitive constrains, it is close to the truth as much as possible. Then, the use of the concept of low-value seems to be one of the crucial concepts in accounting pragmatics.

Given that accountancy is a process of measuring, recording, communicating, and checking, one can say that the purpose of accounting is appropriate measuring and recording, and then communicating the appropriate information. In order to fulfil the condition of “being appropriate,” the information should have certain qualities. Among the financial statement qualities, the ones that come first usually are those two paramount features:<sup>2</sup> fair presentation (reliability), which was mentioned at the beginning, and materiality (defined also as relevance), which will be the subject matter of this article. Those two principles are also pointed out

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2 Conceptual Assumptions of the International Standards of Accounting, up-to-date version and the intended changes are available at: <http://www.ifrs.org/issued-standards/list-of-standards/conceptual-framework/#about>.

by the Polish legislature with regard to reliability and quality (in Article 4(1) of the Accounting Act), as well as relevance (in Article 4(4a) of the Accounting Act).

According to IAS conceptual assumptions as well as US GAAP assumptions, relevant information is useful and complete at the same time. Information is useful when it is capable of making a difference in the users' decision-making in relation to a situation in which they would not have such information. Useful information also allows us to consider alternative forms of activity. Materiality, in turn, means that among a great quantity of events taking place in an economic entity, one should choose those that may be useful in making decisions by the users: the financial statement should include all the information that directly facilitates making decisions by the users of this information, or may influence these decisions. The term 'relevance' (materiality) may be associated with the scope of information that should be disclosed for the general unspecified methods of use: information can be recognised as relevant if learning it may be significant for its users, and thereby, if its omission or misrepresentation may change the assessment or decision of its users.

The Accounting Act provides underlying guidelines as to which data should be disclosed (recognised as relevant) in the financial statement form with a minimal scope of data to disclose. On the other hand, even within the framework of this form, one can make simplifications when a certain amount/event/transaction are not relevant. If they have an irrelevant impact, they can be simplified or even omitted in the financial statement. However, based on the principle of materiality, making simplifications is possible only when it does not distort a given entity's picture. Therefore, it should be emphasised that the principle of fair presentation should take precedence over the principle of materiality (Alexander, Jermakowicz, 2006).

In practice, it is often not easy to say which events taking place in an enterprise significantly influence the situation of a given entity (are relevant/material), and should therefore be considered in the financial statement, and in relation to which simplifications can be applied. As a rule, establishing the levels of relevance should be made with consideration of the specificity of business activity conducted by a given company, its economic situation, and factors such as the quality of its accounting system and internal control.

## 2. The concept of materiality in an accounting system

The materiality threshold is considered in practice by individuals as the amounts calculated as a specified percentage of the balance sheet total. In majority of cases, it is 1% or 2% of the balance-sheet total. Such an approach may entail a variety of risks, though. Thus, the proposition is to calculate the materiality threshold not on the basis of one criterion, but on the basis of four parameters: the balance-sheet total, equity, operating revenue from the sale of goods and services, and gross fi-

nancial result. Selection of different parameters when establishing the materiality threshold means that the proposed model of calculating materiality may be applied by production and service or trade units, smaller and larger units, generating high and low profit margins from sales. In accordance with our proposition, the overall materiality is calculated as an arithmetic average of four figures (all factors have identical weights assigned) which are (Hołda, 2013: 333):

- 1% of balance-sheet total,
- 1.4% of equity,
- 0.8% of the sum of revenues from sales of goods and services,
- 8% of gross financial result.

Materiality calculated this way refers to the financial statement as a whole, which will constitute a valuable threshold for simplifications or errors. The concept of materiality does not only involve the statement as a whole but also its particular items (e.g. goods) or item groups (e.g. inventories). Hence, apart from calculating the overall materiality to indicate an acceptable maximum error (simplification) in reference to the whole financial statement, it is advisable to establish the level of partial (detailed) materiality related to the particular items or item groups of the financial statement. The partial materiality is calculated according to the following formula:

$$I_p = I_o * \sqrt{\frac{\text{the amount of the item or item group of the financial statement}}{\text{element of the financial statement in which a certain item occurs}}},$$

where:  $I_p$  – partial materiality;  $I_o$  – overall materiality, element of the statement – balance sheet, profit and loss account, flow-of-funds account.

For instance: in the event of general relevance of intangible assets; property, plant and equipment; short-term investments, inventories, short-term receivables or active accruals, in the formula for the partial relevance, the denominator will constitute the balance-sheet total. In the case of costs, though (e.g. depreciation, external services, the costs of manufacturing of the sold goods, the rest of the operational costs, or financial costs, or revenues), the denominator in the formula for the partial relevance will constitute the sum of revenues of a given entity from sales of goods and services.

The methodology of calculating materiality based on the objective criteria proposed herein may be used in relation to each reporting item and each economic entity, regardless of the size of the entity, industry within which it operates, or the specificity of its activity. The design of the model and its application have already been described in publications of A. Hołda (Hołda, 2013: 333; Hołda, Pocięcha, 2004: 50–52), therefore, in this article, the model will be applied without duplicating detailed information about its genesis.

The criteria used by the Big Four, and even the former Big Six, accounting firms was the starting point for the development of the model. However, methods of calculating materiality developed and tested in countries with an established market economy do not always work in Poland's economic reality. The main problem encountered in applying Western models of calculating materiality arises from a difference in the financial structure of entities between Poland and the West: Polish companies report relatively high values of balance-sheet totals, mainly because they overstate the value of assets of limited usefulness in relation to their actual (market) value. Moreover, compared to Western countries, the share of equity in the balance-sheet total of Polish companies is relatively high and comes at the expense of profitability. Mechanical application of the criteria used in Western countries in the Polish environment has usually led to an overstatement of the initial estimate of overall materiality. For the reasons mentioned above, it seems reasonable in the Polish environment to reduce the coefficients used to determine overall materiality in the case of equity and balance-sheet total, as well as to use profit before tax rather than net profit for the calculations. The criteria for making an initial assessment of overall materiality are indicated and described in more detail in the literature referred to.

### 3. Critical literature review – materiality and relevance

As E.L. Hicks (1964: 158) points out, the concept and proper understanding of materiality are indispensable for accounting purposes, but while it is essential to set a materiality threshold, it is not possible to set a single, universal materiality threshold for all entities, as it is an individual issue for each entity. As long ago as in 1979, opinions were voiced (Firth, 1979: 283) that regulators should lay down guidelines for setting the materiality threshold, thereby reducing the share of auditors' subjectivity and individual judgement on this issue, but a uniform global model for materiality has not been developed. However, it is not possible to develop such a model, because in every region of the world, in every accounting system, economic realities are different, and therefore local models are most valued as they take into account the specifics of a given region or a given economy. In addition, a new challenge has recently emerged: setting materiality thresholds for disclosures not only of financial data but also for assessing materiality in relation to non-financial data (Moroney, Trotman, 2016). As indicated by the International Standard on Auditing 320 "Materiality in Planning and Performing Audit," materiality may be expressed in terms of both quantitative and qualitative characteristics of the items under review, e.g. accounting records and evidence of or compliance with prudential standards by the entity.

In practice, numerous models have been developed that can be used to estimate the materiality threshold. Many of these models were developed for use by audi-

tors, whose opinions on the financial statements depend primarily on whether the irregularities found in the financial statements are material or immaterial.

It is possible to distinguish 'single rules' models, in which several variables are used to determine the materiality threshold, with a percentage threshold being determined for each variable. An example of such a model created for the conditions of the Polish market is the aforementioned model of A. Hołda (2013). There are also models of a 'variable or size rules' type in which rather than a threshold value for each factor, a range is given, for example: 1% to 3% of Gross Profit if it is less than PLN 50,000.

In practice, models which are popular and often cited in the world literature include the model used, for example, by KPMG (McKee, Eilifsen, 2000): Materiality = 1.84 times (Greater of Assets or Revenues)<sup>2/3</sup> or the ACCA model (0.5–1% of turnover, 5–10% of profits reported and 1–2% of gross assets).

It should be noted that since 1 January 2020 the definition of materiality itself has been amended (or rather adapted to the changing reality). Originally, materiality was defined as: Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. The new definition indicates that "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity" (IFRS, 2018).

The hypothesis put forward in this paper is part of the new definition of materiality: each enterprise should determine for itself which information may be material to the users of its financial statements, and in particular if, in terms of the recognition of low-value fixed assets in accordance with the tax law, this will not affect decisions made by the users.

## 4. Balance-sheet recognition of low-value fixed assets in view of the change in the limit value of one-off depreciation charges in tax regulations

In economic activity, constituents of property, i.e. property, plant and equipment items, are crucial in many respects for appropriate presentation of the economic information generated by the accounting system. Especially their value recognition and making potential simplifications may be doubtful. As for the fixed assets with low unit value, they may either fall into this category in accordance with general principles, or – according to the principle of materiality set out in Article 4(4) and (4a) of the Accounting Act – not to be considered as fixed assets at all. It is also possible

to establish for them depreciation and amortisation write-offs in a simplified manner by making one-time depreciation (under Article 32(6) of the Accounting Act). The Accounting Act provisions do not define the value criterion that determines the absolute necessity to qualify some resource as a fixed asset, but only indicate the principle of materiality or fair and faithful presentation of a given entity's financial situation. Establishment of the limit amount for presentation of low-value assets lies in the competence of the entity's director who specifies the rules for recognition of fixed assets (including intangible assets) in its accounting policy (Hołda, Staszek, 2020: 6).

In practical terms, entities often used the tax criteria for recognising fixed assets, especially the limit value for recognition of fixed asset amounting to PLN 3,500 until the end of 2017. It should be remembered, though, that the amount PLN 3,500 is the criterion for tax purposes (in accordance with Article 16d(1) of the Corporate Income Tax Act and Article 22d(1) of the Personal Income Tax Act), not necessarily for accounting purposes. According to the Act of 27 October 2017 on the amendment to the Personal Income Tax Act, the Corporate Income Tax Act, and the Act on Flat-rate Income Tax on some income generated by natural persons, the amount of PLN 3,500 applied for 17 years in tax law, often used in balance-sheet law too, was replaced with the amount of PLN 10,000.

In our opinion, the change in the tax amount for deducting fixed assets from PLN 3,500 to PLN 10,000 does not make a great change within the tax law, but has numerous implications in accounting. As regards the entities which within the framework of balance-sheet law are not using the tax recognition of fix assets at the moment (and have not adopted the limit value of PLN 3,500), thus keeping a separate balance-sheet and tax accounts for their fixed assets, the amendment to provisions will have an impact only on the aspect of tax recognition of fixed assets. These entities, though, constitute a rather small group. For the majority of economic entities that assume tax rules for recognising fixed assets, the amendment to tax regulations will entail the necessity of making changes also in their accounting policy, or also differentiating the tax deduction of fixed assets from their tax recognition.

## 5. Change in the balance-sheet limit value for the recognition of fixed and intangible assets

Owing to the change in tax regulations, the entities that assumed the tax limit value of PLN 3,500 for recognition of fixed assets and intangible assets will need to make a significant choice as to which new solutions of recognition of low-value assets to assume. For instance, the entities can differentiate between tax and balance-sheet recognition of fixed assets: leave the balance-sheet limit value of recognition of asset in the amount of PLN 3,500, but make one-off depreciation



of assets in the amount of PLN 10,000 for tax purposes. Leaving the low-value limit at the level of PLN 3,500 for tax purposes is possible, too. However, the tax regulations specify the current limit value in the amount of PLN 3,500, and since 2018 the maximum value has amounted to PLN 10,000. Consequently, it does not preclude the possibility of leaving – also under the Polish law – the limit of recognising fixed and intangible assets in the amount of PLN 3,500. With this solution, accounts of fixed assets kept for the balance-sheet purposes are tax accounts at the same time, and there are no changes to the accounting policy, although the drawback of the above-mentioned solution is that the entity will not use the possibility of recognition of the expenses for purchase of fixed assets in the amount of no more than PLN 10,000 directly as tax deductible expenses, which could have a great impact on lowering the tax base and, consequently, paying lower taxes. Another option to consider is the adoption of the low-value limit of PLN 10,000 for balance-sheet purposes. If an entity determines that as of January 1, 2018 it wants to assume the limit value of recognising fixed assets in the amount of PLN 10,000, then such change should be accounted for in accordance with KRS 7 as a change in its accounting policy. Then the entity retrospectively recognises the changes (i.e. such changes as if the newly adopted rule has always been applied), which requires:

- referring the effects of changes in the adopted accounting principles (policy) (i.e. changes in the rules for recognition of fixed assets) to equity (fund), presenting them as a profit (loss) of the previous years,
- restating comparative data retrospectively in the financial statements,
- presenting the effects of changes in the adopted accounting principles (policy) in the appropriate item of the statement of changes in the equity capital (fund), if obliged to do this,
- disclosure of relevant information in the notes.

The application of a full retrospective approach is associated with substantial work inputs, however, it ensures compliance with the principle of comparability of reporting data, which is set out in the Accounting Act. It should be emphasised that numerous scientific studies (Nobes, Stadler, 2015; Buk, 2016), conducted both in Poland and in the world, indicate that the change in the accounting policy applied so far may fundamentally alter the picture of a given company's financial situation.

Considering the adoption of the described solution, one more question should be asked: whether, considering both the principle of materiality and the principle of a reliable and clear picture, property, plant and equipment as well as intangible assets amounting to PLN 10,000, which will not be classified as fixed assets due to the 'irrelevant' amount, **really constitute an irrelevant item**, and whether it is reasonable to assume the limit of materiality for fixed assets or intangible assets and recognition of them in the accounting books or financial statements in the



amount of PLN 10,000. Considerations on materiality and the presentation of empirical research in this respect are included in Section 5.<sup>3</sup>

If entities recognise that the limit for the recognition of fixed assets at the level of PLN 10,000 is too high and will make it impossible to comply with the principle of fair presentation of the economic reality in accounting books after the adoption of such a high materiality threshold for fixed assets, they will want to take advantage of the possibilities of increasing the tax threshold for recognising fixed assets. Then, in order not to keep separate accounts of fixed assets for balance-sheet and tax purposes, entities may accept as their materiality threshold an amount higher than PLN 3,500 (e.g. PLN 5,000, PLN 7,000), but not necessarily the upper taxable limit, i.e. PLN 10,000. This solution is, of course, acceptable for tax purposes (the amount of 10,000 is the maximum amount).

When determining the optimal balance-sheet solution – in the face of a significant change in tax – which will involve simplifications, individuals should determine the level of materiality, indicating the limit for making such simplifications, without breaking the ‘true and fair view’ principle. Determination of the level of partial materiality, not only for fixed assets and intangible assets, but also for all assets for which the notion ‘low-value’ can be extended, is possible thanks to application by the authors the methodology of establishing the level of materiality presented in Section 1.

## 6. Materiality of the amount of PLN 10,000. Average materiality indicators for fixed assets for stock exchange listed companies – results of empirical research

In order to draw conclusions on the possibility of adopting – for the purpose of the balance-sheet law – the tax threshold for recognition of fixed assets (PLN 10,000), the levels of overall materiality and selected partial materialities for 80 randomly selected companies which are not traded on WIG30, mWIG40 or sWIG80 but belong to the smallest entities listed on the Warsaw Stock Exchange were examined. The levels of materiality were determined on the basis of separate financial statements of the aforementioned companies drawn up for the years 2007–2014. In total, the analysis covered 640 financial statements.

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3 More about the meaning of the principle of materiality for financial statements also in: Kabalski, 2006.

The average level of overall materiality in the analysed financial statements of the surveyed companies amounts to PLN 1,989,000. The average level of partial materiality for property, plant and equipment amounts to PLN 762,000, and for depreciation: PLN 262,000. It should be emphasised that the analysed business entities are large enterprises listed on the WSE. The analysis of the level of materiality for these companies allows us to say that they could adopt from 1.01.2018 – for the balance-sheet purposes – the tax principles of one-off depreciation of assets to the value below PLN 10,000. However, at the end of the period, these entities should verify whether the materiality threshold has not been exceeded. For example, if in a given period a company purchased 30 fixed assets (e.g. computer sets) in the unit value of PLN 9,000 and made one-off depreciation to them, the total value of one-off depreciation would amount to PLN 270,000 (i.e. 30 items  $\times$  PLN 9,000/pcs.), thus exceeding the threshold of partial materiality determined for depreciation, becoming a material (relevant) amount. In such a case, one-off depreciation of the purchased computer sets would constitute material irregularity in the financial statements.

Recognition of the amount of PLN 10,000 as a non-material amount, and thus the possibility of not including the expenditure incurred in the amount of less than PLN 10,000 in fixed assets (making a one-off write-down) in the units analysed (i.e. the smallest companies among the entities listed on the Warsaw Stock Exchange), is potentially possible, however, at the end of the financial year an analysis is required whether for sure the materiality threshold has not been exceeded. However, the smaller the enterprise, the lower the level of overall materiality determined for the data contained in its financial statement, as well as the level of partial materiality. Therefore, it can be questioned whether in the case of smaller economic entities than the companies analysed, the recognition of the amount of PLN 10,000 (regarding the recognition of fixed assets or depreciation) as irrelevant is justified.

As part of this research on the level of partial materiality concerning fixed assets and depreciation, the financial reports of 2007–2014 of 68 randomly selected stock exchange listed companies traded on the WSE (the companies are entities operating within various industries, listed on the WIG30, mWIG40, and sWIG80 indices) were also reviewed. At this stage of the research, 544 financial statements were analysed. Table 1 presents averaged indicators of partial materiality for fixed assets and depreciation in the years examined for the analysed companies with the division into companies belonging to particular WIG indices (based on the data of 544 financial statements) as well as non-WIG companies (based on the analysis of 640 financial statements).

The collected results are summarised in a breakdown table and verified using the chi-square statistical test. The chi-square test statistic value was 273.84 with a test probability  $p < 0.05$ , which means that the relationship between the size of the company and the level of partial materiality set for it is statistically relevant: the smaller the unit, the smaller the level of partial materiality determined for fixed assets and for depreciation.

Table 1. Averaged selected partial materiality indicators for groups of the companies listed on the Warsaw Stock Exchange [in PLN]

	<b>WIG 30 companies</b>	<b>mWIG40 companies</b>	<b>sWIG80 companies</b>	<b>non-WIG companies</b>
Partial relevance – Property, plant and equipment	42,642,000	4,062,000	1,743,000	762,000
Partial relevance – Depreciation	,777,000	1,884,000	759,000	262,000

Source: own elaboration

The results of the studies confirmed the statistically intuitive expectation that the levels of partial materiality calculated for depreciation and fixed assets significantly depend on the size of the economic entity: the smaller the unit, the smaller the level of partial materiality for depreciation, and thus the smaller the unit, the more attention should be paid whether from the accounting point of view one-off depreciation in amounts close to PLN 10,000 does not distort a given entity's picture presented in its financial statement.

The next step was to examine financial statements of 337 Polish companies (that keep their accounts in accordance with the Polish Act of Accounting) from the years 2010–2017. A total of 2,696 financial statements were analysed. This group of randomly selected companies was smaller, not listed on the WSE. The structure of assets belonging to the examined companies is presented in Table 2.

Table 2. The structure of assets belonging to the examined companies listed on the Warsaw Stock Exchange

<b>Large entities</b>	<b>Number of entities</b>
Total assets under PLN 100,000	9
Total assets from PLN 100,000 to PLN 500,000	26
Total assets from PLN 500,000 to PLN 1,000,000	36
Total assets from PLN 1,000,000 to PLN 2,000,000	39
Total assets from PLN 2,000,000 to PLN 3,000,000	39
Total assets from PLN 3,000,000 to PLN 5,000,000	54
Total assets from PLN 5,000,000 to PLN 10,000,000	57
Total assets from PLN 10,000,000 to PLN 20,000,000	45
Total assets more than PLN 20,000,000	32

Source: own elaboration

The results of the analyses have shown that:

- The average level of fixed assets in 337 companies is PLN 1,599,000.
- The average level of depreciation in 337 companies is PLN 42,000.
- The average overall materiality in the analysed financial statements of the surveyed companies amounts to PLN 18,000.

- The average level of partial materiality for property, plant and equipment amounts to PLN 14,000, and for depreciation: PLN 14,000.
- The average level of partial materiality for depreciation is PLN 2,000.

The results indicate that the value of depreciation in the amount of PLN 2,000 is a significant amount, and thus it may significantly affect the image of an entity contained in its financial statements.

Considering the fact that annual depreciation in the amount of 2,000 affects the reliability of the reporting information, or that it can lead the auditor to issue an opinion other than ‘without reservations,’ it is questionable whether it makes sense to raise a one-off depreciation threshold in smaller units from PLN 3,500 to PLN 10,000. Our observations during the audit of financial statements or conversations with statutory auditors and chief accountants also show that only a few entities have decided to change their accounting policy and make a one-off depreciation of fixed assets of up to PLN 10,000. The majority of entities have left the lower limit of recognition of fixed assets at the level of PLN 3,500, thus separating the tax law from the balance-sheet law with regard to depreciation of low value assets.

## 7. The possibility of simplified accounts of low-value assets other than fixed assets and intangible assets

It is worth considering whether, since an entity uses simplified accounts in relation to low-value fixed assets or intangible assets, it is also not reasonable to apply simplifications in relation to other reported items, for example, insignificant amounts of accrued expenses, which are painstakingly settled in monthly periods, and which do not significantly affect either the assets or the financial result of the entity.

The Accounting Act explicitly refers to the possibility of a simplified account of fixed assets and intangible assets (in Article 32(6)), as well as materials, goods, production in progress or finished products. However, Art. 8(1) of this Act indicates that when defining accounting (policy) principles, it is important to emphasise in accounting all events relevant to the assessment of the asset and financial situation as well as financial result of an entity. Thus, the legislator allows entities to refrain from emphasis of irrelevant events, pointing to the possibility of simplified accounts. Therefore, extending the concept of low-value to other assets is possible through the principle of materiality: materiality is a tool for introducing low-value of various balance-sheet items (for example, accrued expenses or receivables), and low-value can be treated as a form of materiality limit (the threshold of materiality).

## 7.1. Examples of the use of simplified asset accounts indicated explicitly by the Accounting Act

If the materials (including goods) are found to be of low value, the entity may value them at the selling price instead of at the acquisition price.<sup>4</sup> The legislator also indicates that if products are considered non-material in the course of production, then they can be measured as for balance-sheet purposes in the amount of direct production costs, or in the amount accounting only for the materials used to produce them, or even not to be valued at all.

Pursuant to the Accounting Act, it is possible not to apply the provisions regarding the method of settling revenues and costs arising from long-term contracts (and therefore register them in a simplified way) when the share of revenue from incomplete services on the balance-sheet date is non-material relative to the total operating revenue in the reporting period.<sup>5</sup> The Accounting Act also indicates – but only in relation to strictly defined entities in Art. 28(4a) – the possibility of not applying the considerations of the idle production capacity when calculating the cost of manufactured finished products.

In each of the above-mentioned cases, the fact and rules of applying simplifications should be clearly indicated by a given entity's manager in its accounting policy. Particularly in the case of inventory components, it is important to clearly indicate the applicable accounting principles and establish the inventory components for which subsidiary ledger accounts are kept, because in accordance with Art. 37 of the Accounting Act, the subsidiary ledgers are kept for “the assets material for the entity,” and therefore it is possible to resign from keeping subsidiary ledgers for the assets recognised as of low value.

However, the above-mentioned list of simplifications possible to make in asset recognition is not a closed list, given the fact that one of the main principles many times indicated by the legislator is the principle of materiality. Therefore, it is in the competence of a given entity's manager (under appropriate provisions in its accounting policy) to decide what values will be presented in assets and liabilities, and which will be charged to the financial result as regards the recognition of the effects of events considered irrelevant. Importantly, materiality is focused on what is presented in the accounting disclosures, because the effects of economic events will be registered after all. However, depending on whether these effects significantly affect the financial statements or not, these accounts may be made on the basis of general principles or – in the authors' opinion – in a simplified manner, analogically to the one explicitly indicated in the Accounting Act: simplified accounts of fixed assets, intangible assets, and inventory components.

4 Art. 34(1) of the Accounting Act.

5 Materiality can be determined using the proposed partial materiality index where the numerator in the formula should include the amount of the income from incomplete service, while the denominator should include an amount which is the sum of all revenues of the entities.

## 7.2. Examples of the use of simplified asset accounts based on the principle of materiality

In accordance with the principle of materiality, some expenses which should constitute (on account of the period of time they refer to) prepayments may be considered as of low value.

If the amounts of these expenses are considered non-material, it is possible to resign from prepayments and to register one-off expense at the date of its payment. In accordance with the materiality principle, an entity may set a threshold below which it will not settle prepayment (in spite of the fact that in accordance with the meaning of economic transaction – e.g. purchase of five-year insurance – this should be done), but recognise a one-off expense when it was incurred. Such a situation may apply to the purchase of insurance, subscriptions and even the repair expense to fixed assets or rental fees. One may ask whether it is really economical to distribute the cost of an annual magazine subscription (to accounts) in the amount of PLN 600 and recognise the amount of PLN 50 as a cost monthly, instead of a one-off recognition as the cost of PLN 600 in the month of subscription purchase. If the given amount is considered as non-material, and thus does not distort the reporting information, then it is possible – based on the principle of materiality – to depart from booking the prepayments and instead record the one-off charge of the costs.<sup>6</sup> The condition for applying such a solution is to establish a materiality threshold for this type of expenditure (the establishment of the partial materiality also for prepayments is possible using the model of partial materiality calculation proposed by the authors) and a clear indication in the accounting policy what type of expenses and what amounts can be considered ‘of low value,’ and thus accounted for in a simplified way. The condition for applying such a solution, however, is to verify whether the total amount of simplifications applied to the accounts recognised as of low value is not a material amount (as it is in the case of the simplified recognition of low-value fixed assets).

An entity may also consider the costs of the current period for which expense will occur in later periods, including the accrued expenses related to warranty repairs or employee benefits, for example, holiday benefits. However, low value in the case of accrued expenses should be introduced in the entity with a high degree of caution: low-value expenses are those which are not cumulative and are not transferred over several reporting periods (e.g. holiday benefits, compensation payable in the next period, or the cost of possible warranty repairs that may take

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6 Empirical research on a group of 148 companies listed on the Warsaw Stock Exchange showed that the average partial materiality index calculated for the sum of prepayments for those companies for the years 2007–2014 amounted to PLN 1,138,000. However, the average partial materiality index calculated for a group of 80 companies listed on the Warsaw Stock Exchange but not belonging to WIG30, mWIG40 or sWIG80, amounted to PLN 329,000.

place in the near future), and which, therefore, due to their low value, permit refraining from making accrued expenses to cover them. On the other hand, in the case of the expenses that may accumulate over several reporting periods, even if they are identified as of low value in a certain period, simplifications cannot be made, because these costs in total, incurred in several reporting periods, may become a material amount: for example, the costs for accrued expenses of retirement benefits or jubilee bonuses.

The concept of low value may also be referred to other assets: for example, if an entity considers finished products to be of low value, it may choose not to determine the spare production capacity when calculating their value; what is more, if the products are considered as of low value, the simplified valuation is based on the assumption that these products are of low value, but in the case of statutory exemption from the apportion of costs for spare production capacities, it is assumed that the amount of these costs is not material, and hence it is possible to apply their simplified accounts.

Similarly, if an entity makes simplified accounts of materials (including goods) with the consent of the entity's manager by charging to costs the value of materials and goods at the date of their purchase, as well as determining the state of the assets, their valuation and the adjustment of costs by the value of that state (i.e.: considering the value of these assets at the balance-sheet date as non-material), then the cost adjustment may be waived by the value of low-value materials (goods) as at the balance-sheet date.

The low-value criterion may be applied also to the receivables, in particular to those receivables for which the costs of their investigation exceed the value of the receivable itself. In this case, writing down their value is both economically reasonable and in line with the tax approach, which indicates that one of the forms of documenting non-recoverability of debts is preparing a protocol by a taxpayer stating that the envisaged legal and enforcement costs related to debt recovery would be equal to or higher than the amounts of receivables.<sup>7</sup>

Although the concept of low value is commonly associated with fixed assets and intangible assets, according to the theory of accounting, it is possible to extend this concept also to other components of the balance sheet, as shown above. The indicated solutions, although not explicitly mentioned in the Accounting Act, but in accordance with its spirit and the principle of materiality, may turn out to be a significant convenience, which, however, will not adversely affect the quality of information presented in the financial statements. Recognition of a certain asset (cost or liability) as low-value may affect not only the manner of its recognition in the accounts and financial statements, but also affect the applied inventory method.

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7 Art. 16(2)(3) of the Act on Corporate Income Tax.



It should be remembered that the recognition of a single asset or transaction as low-priced is not a 100% guarantee for making simplification, because the low-value of a single transaction does not ensure that a group of several or a dozen low-value transactions during the financial year will have no significant effect. Therefore, it is crucial to verify, at the end of the reporting period, whether the simplifications introduced into low-value transactions altogether do not constitute a significant deformation of the reporting information.

## 8. Conclusions

A significant change in tax regulations, allowing for one-off depreciation of assets in the amount of no more PLN 10,000, was an incentive to take up the subject of recognising low-value assets in the balance-sheet law. The change of the lower limit of fixed assets (as well as intangible assets) from PLN 3,500 to PLN 10,000 has numerous effects on accounting: entities that have adopted for accounting purposes the tax limit for recognising fixed assets (and this is a vast majority) are facing – due to the changes in tax regulations – the necessity of verification as well as possible changes in the accounting (policy) principles, or differentiation of the tax and accounting way of recognising fixed assets, which complicates their accounting considerably.

The range of acceptable solutions (especially in the case of convergence of tax and balance law) in the area of recognition of fixed assets and intangible assets, along with considerations on the validity of adopting these solutions, is presented in Section 3, considering, among others, whether it is possible to change the lower limit of recognition of low-value assets without the necessity to retrospectively restate data due to a change in accounting principles (policy). It has been shown that there are many arguments in favour of renouncing the retrospective restatement of data for the preceding year, especially since it is time-consuming and requires a great deal of attention. Departure from the retrospective restatement of comparative data is possible based on the principle of materiality: if the effects of not making retrospective restatements are not material, one can refrain from making restatements (Hołda, Staszal, 2018).

In the further part of the article, the fact that the concept of low-value can be also referred to assets, transactions and events related not only to fixed assets or intangible assets is presented. Areas in which it is possible to apply simplifications to operations with non-material value are numerous, and each entity should individually specify – in its accounting policy – what principles to apply to individual assets/transactions/events considered to be of low value, as well as what amount constitutes the limit value for the recognition of certain reporting items as non-material. It must be remembered that it is the principle of materiality that is the tool for inclusion of low value.

The determination of the materiality threshold for all the above mentioned assets and events can be based on the basis of the partial materiality index, the calculation methodology of which is presented in Section 1. The presented model for determining overall materiality and partial materiality is a universal model and can be successfully used by various economic entities.

To conclude the considerations of low value and materiality, it is worth noting that the entities which really want to observe the principles of true and fair view, and thereby achieve the goal of accounting, i.e. show the true (fair) picture of a given economic entity in the accounting books, should themselves determine whether applying certain simplifications, those explicitly indicated in the Accounting Act and those resulting from the accounting principles, will not cause a distortion of the reported data, and thus will significantly affect not only the amount of the financial result, but the entire picture of the entity in the financial statements. It should be noted that now not only the profit category itself is important for investors when making decisions, but also other items of the financial statements (Barth, Ken, McClure, 2017).

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### Pojęcie niskocенności w kontekście środków trwałych

**Streszczenie:** Celem artykułu jest ukazanie możliwości stosowania uproszczeń w rachunkowości, w szczególności w zakresie ujmowania środków trwałych oraz innych pozycji bilansowych, zgodnie z zasadą istotności i dochowując zasady wiernego odzwierciedlenia. Aby osiągnąć ten cel, wykorzystano dedukcyjno-indukcyjne metody badawcze w postaci przeglądu literatury, analizy treści sprawozdań finansowych oraz statystycznej weryfikacji ustaleń.

Stosowanie uproszczeń w rachunkowości jest możliwe pod warunkiem, że nie zniekształca to obrazu jednostki ukazanego w sprawozdaniu finansowym, a tym samym nie wprowadza w błąd użytkowników tego sprawozdania, czyli nie jest istotne. Określenie progów, od których daną informację należy uznać za istotną, jest zadaniem trudnym, a równocześnie kluczowym w sprawozdawczości, jak również rewizji finansowej. Autorzy w artykule prezentują model, który pozwala na wyznaczenie poziomów istotności (zarówno w stosunku do całości sprawozdania finansowego, jak i poszczególnych jego elementów) w każdej jednostce gospodarczej, niezależnie od jej wielkości czy branży, w której funkcjonuje. Zaprezentowany model wynika z danych sprawozdawczych polskich przedsiębiorstw, stanowiąc korektę podobnych modeli stosowanych w krajach Europy Zachodniej, i ułatwia określenie zobiektywizowanego poziomu istotności cząstkowej w zasadzie dla wszystkich pozycji sprawozdawczych.

Wykorzystując zaprezentowany model, autorzy przeprowadzili badania na grupie 148 spółek giełdowych, analizując sprawozdania finansowe tych jednostek sporządzone za lata 2007–2014 i dokonując tym samym przeglądu danych zwartych w 1184 sprawozdaniach finansowych, oraz na grupie 337 mniejszych polskich spółek, analizując ich sprawozdania finansowe za lata 2010–2017 i dokonując przeglądu danych zwartych w kolejnych 2696 sprawozdaniach finansowych. Łącznie przeanalizowano dane z 3880 sprawozdań finansowych. Z przeprowadzonych badań wyciągnięto wnioski dotyczące możliwości stosowania przez jednostki uproszczeń w zakresie ujmowania środków trwałych. Badania umożliwiły wskazanie progów istotności dla jednostek notowanych na WIG30, mWIG40, sWIG80 oraz spółek giełdowych nienotowanych na żadnym z wymienionych indeksów, w szczególności istotności cząstkowej liczonej dla amortyzacji. Analiza wyników badań, w tym zastosowanie testu chi kwadrat, pozwoliło podać w wątpliwość to, czy z punktu widzenia rachunkowości finansowej dokonywanie jednorazowych amortyzacji w kwotach zbliżonych 10 000 zł (co jednostki mogą chcieć praktykować w związku ze zmianą przepisów podatkowych) nie zniekształca obrazu jednostki prezentowanego w jej sprawozdaniu finansowym. Hipotezą badawczą artykułu jest konstatacja, że nie wszystkie jednostki prowadzące księgi rachunkowe mogą stosować przepisy podatkowe w zakresie ujmowania nieskocennych środków trwałych.

**Słowa kluczowe:** niskocенność, istotność, wiarygodność, środki trwałe, wartość bilansowa

**JEL:** M41

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