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THE FIRM'S PATRIMONY – AN INTERNATIONAL APPROACH

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Abstract

This article is meant to reinterpret the balance equation of the Patrimony. Any book about the Foundations of Accountancy presents in the chapter "The Object of Accountancy", the patrimonial equation mentioned above. We state the following affirmation: in the accountancy of a firm, everything is thought over from the point of view of the respective firm. However, this small detail seems to have been overlooked by authors of accountancy manuals when they presented the equation mentioned above. And we observed that this small detail attracted a lot of confusion even among people with many years of experience in accountancy. This article will offer a new point of view regarding the concept of a firm's Patrimony on an international approach.

Keywords: accountancy, patrimony, assets, liabilities, owner's equity.

JEL Classification: M410

1. Introduction

The essential problems in characterizing a science are establishing its object of study and its method of research. These aspects allow the respective science to have a clear and precise position among all sciences, to establish relations with related domains and to specify its importance and utility in the process of knowledge. As a science, accountancy has established over the centuries more or less its content and object of study. The first definition of accountancy was given by Luca Paciolo (Caraiani 2005) and written down in Venice in 1494 in the mathematics and geometry work „Summa de arithmetica, geometria, proportioni et proportionalitá" which includes „Tractatus de computis et scripturis", meaning The treatise of double entry accountancy. He considers that the object of accountancy is „everything which the merchant considers to be his and all the big or small businesses in the order in which they took place" (Capron 1994). Although it is the first treatise of double entry accountancy, Luca Paciolo does not claim the paternity of this system, he only describes the system used by merchants in Venice and Florence. Regarding the object of accountancy, in historic evolution, numerous discussions and debates took place. Starting from Luca Paciolo's definition (Baciu 1997), a great number of reformulations were made through which the object of accountancy was defined, but without any unanimous cohesion.

2. Concepts regarding the object of accountancy

In the accounting literature, four concepts regarding the object of accountancy are known: administrative, legal, economic and financial (Popa 2009).

In the administrative concept, which belongs to the italian school (E. Pisani, G. Massa, V. Gitti), the object of accountancy refers to the reflection and the value control of administrative facts in order to obtain maximum economic effects with minimum efforts (Negrescu 1996).

The legal concept, cultivated by the german school (F. Hugli, R. Reisch, I. C. Kreibig) and adopted in our country by professors G. Tancu Iaşi, S. Iacobescu, A. Sorescu, considers that the object of accountancy is represented by the patrimony of a natural person or of a legal person regarded from a legal point of view, namely from the point of view of rights and material obligations in relation to the corresponding objects (goods, values). In this concept, accountancy is the science of recording the trade equalities from a person's patrimony.

The economic concept, which is very widespread in the European accountancy schools (J. Fr. Schar, R. P. Coffy, E. Leautey, A. Guibbault, A. Gibert, I. Evian, C. Panţu, D. Voina), defines the object of accountancy as a circuit of capital regarded from the point of view of destination (fixed capital and working capital) and of the source (national and foreign capital). Hence, R. P. Coffy shows that in the object of accountancy, "the solution to the following problems plays an important part: given a capital made by a common method, meant to be used, all of it or just a part of it successively, in different uses and likely to suffer certain changes in its nature and amount, it has to observe this capital in all its successive changes at a time fixed according to the will, nature and position of each of its component parts, all the increases and decreases that it suffered, to reveal the causes of these variations and the part played by each of these causes in the overall effect or in a partial effect". In this concept, J. Fr. Schar considers as an object of accountancy "the movement of individual capital as well as its expenses and income".

The financial concept views the object of accountancy as a part of the research and solution to the value chains of our existence, a part of the movement and change of the patrimonial resources which it treats starting from their source (permanent and temporary resources) and from their use (durable and cyclic uses). In some papers, the source of the resources is also structured from the obligations' perspective (obligations toward the owners and toward other persons).

The financial concept has more and more followers and it is accepted by the contemporary schools of accountancy (Malciu 1999). This concept together with the economic one represents the basis of the studies for the establishment of international accountancy conventions and standards. Taking into account the definition of the object of accountancy in historic evolution and its particularities on the market economy (Cistelecan 2000), we consider that the definition of the object of accountancy should also include the patrimony viewed economically, legally and financially, as well as the financial results of economic agents, therefore a legal-economic and financial perspective on patrimony.

3. The content of the object of accountancy

The object of accountancy is represented by the state of the patrimony from the money perspective, by its movement and transformation as a result of the economic operations and the obtained results. Any economic unity and budgetary institution is different from others of its kind in relation to its patrimony (Luca 1999).

The patrimony is represented by the set of rights and obligations of economic nature expressed in money together with the goods which they refer to and which belong to a natural or legal person no matter the source (Horomnea 2001). Hence, in order to have a patrimony, two elements are necessary:

- *the subject of patrimony*, namely a natural or a legal person, who is in the possession of material goods and controls them, who has the corresponding rights and obligations, being able to exert acts of disposition and administration over the patrimony;
- *the objects of patrimony*, the material goods and money, as objects of the rights and obligations relations.

Viewed as utility values, these objects or goods, as components of the patrimony, represent the wealth of natural or legal persons. The use of this wealth in economic activity is expressed by the notion of „economic means (goods)".

Hence, the patrimony of a unity brings together two main elements: patrimonial elements of the material means and money type expressed on a value scale and sometimes quantitatively and patrimonial elements of the legal relations type which unities create for themselves in the process of their activity, relations materialized in rights and obligations. Therefore, the patrimony, from the perspective of structure, includes the legal and the economic patrimony (Doinea 2002).

The economic patrimony represents the set of goods (means, wealth) which belong to an economic agent, used in order to develop the object of his activity by a natural or a legal person, no matter the source of the respective goods.

The legal patrimony represents the legal relations, rights and obligations which are created in patrimonial unities as a result of the existence and use of the economic patrimony (Drăgan 1995).

Legal relations are important components of the patrimony and include categories of rights and obligations, among which the most common are (Epstein 2007):

a) the rights of the patrimony subject:

- the ownership rights over goods and values which belong to him;
- the claim rights over other persons for the transferred goods and values;

b) the obligations of the patrimony subject:

- internal obligations, toward the associates or shareholders for their contribution to the society's capital;
- external obligations, toward other persons for the received goods and services, credits, work, taxes, etc.

We can conclude that the object of accountancy is found in a patrimony which contains, structurally speaking, both the economic and the legal patrimony, because an economic patrimony cannot exist without a legal patrimony and vice-versa.

The object of accountancy, reflecting the patrimony of unities, is represented by the evidence, calculation, control, movement and change of the economic means (goods) as a result of the economic processes in connection with the corresponding legal relations (Feleagă 2005).

In conclusion, the content of the object of accountancy is represented by patrimony, evidence, calculation and control of the existence, movement and change of the economic means within the framework of the economic processes, the final result of these movements and changes, the legal relations which generate rights and obligations, mirrored in money standard and sometimes quantitatively in the perimeter of the patrimonial unities (Feleagă 1998).

4. New own points of view regarding the interpretation of a firm's patrimony

This article is meant to reinterpret the *balance equation* of the *Patrimony*, which, in accountancy, appears under the form: Economic goods = Rights + Obligations.

Any book about the Foundations of Accountancy presents in the chapter "The Object of Accountancy", the patrimonial equation mentioned above. We state the following affirmation: *In the accountancy of a firm, everything is thought over from the point of view of the respective firm.* However, this small detail seems to have been overlooked by authors of accountancy manuals when they presented without further consideration the equation mentioned above. Therefore, in the explanations that we encounter in accountancy books, we find out that the Rights relations take into account the owners' rights over their personal wealth, rights which they brought into the firm when it was established or which they have earned gradually from the firm's activity. But what do we notice? The notion of *rights* (receivables) has not been taken into account from the firm's perspective, but from the shareholders' (owners') point of view. Hence, if shareholders have indeed rights (receivables) over the firm, doesn't this mean that the firm has debts toward its shareholders? Of course it has! Why are we interested in the firm's perspective? Because, as said before, everything in accountancy should be thought over from the firm's point of view. The accountancy of a firm is kept at the firm, not at its shareholders. Therefore, through the notion of *Rights* (the shareholders' rights over their firm) from the equation mentioned above, we understand in fact the firm's *Debts* to its shareholders, regarded from the firm's point of view.

Through the notion of Obligations we understand Debts. Whose? The firm's or shareholders' debts? The accountancy is kept at the firm, so the answer is very clear: the firm's Debts. If the notion of Rights means in fact the firm's Debts to its shareholders, then the notion of Debts means the firm's Debts to other persons, namely to everybody else except the shareholders. So, there are two categories of a firm's debts: the firm's Debts to its shareholders – which we can call *Internal Debts* and the firm's Debts to other persons – namely *External Debts.*

Through the firm's Economic Goods we understand the firm's Wealth, meaning any goods or values that the firm has and which are used in order to generate new surpluses of goods and values. In the equation mentioned above, if we replace the notion of *Rights* with *Receivables*, the notion of *Economic goods* with *Wealth* and the notion of *Obligations* with *Debts*, then we will have an equation of the type: Wealth = Receivables + Debts, equation which, regarded from a firm's point of view, has never been encountered in accountancy under this form. Why? Because the equation Assets = Equity + Liabilities, meaning the equation which lies at the foundation of accountancy, is not encountered under this formula. If the Assets mean the firm's Wealth and the Liabilities don't mean the sum of receivables and debts of a firm, because the receivables are, by definition, a part of the firm's Assets, from the firm's Wealth and we will see why.

To sum up, when the great patrimonial equation was established under the form Economic Goods = Rights + Obligations, a big confusion was made: the notion of Rights was used with the sense of *Receivables of the shareholders toward the firm*, instead of using the notion of *Debt of the firm toward the shareholders*, which practically means the same thing, but from the firm's point of view. So, starting from the patrimonial equation mentioned above, we will never reach, step by step, the accountancy fundamental equation, namely the simple patrimonial equation Assets = Equity + Liabilities (A = E + L), because, in accountancy, everything should be taken into account only from the firm's perspective, assumption rarely respected in the primordial patrimonial equation Goods = Rights + Obligations.

This is how we see logically explained the patrimonial equation of a firm. The Net Patrimony at a certain moment in time is represented by what the firm *has*, to which we add what the firm *has to receive*, from which we extract what the firm *has to give*. Putting all this into a formula, the primordial patrimonial equation could be written under the following form from Figure 1:

$$\textbf{Net Patrimony} = \underbrace{\underbrace{\textbf{Money + Goods}}_{\text{what the firm } \textbf{has}} + \underbrace{\textbf{Receivables}}_{\text{what the firm } \textbf{has to receive}}}_{\textbf{Assets}} - \underbrace{\textbf{Liabilities}}_{\text{what the firm } \textbf{has to give}}$$

$$\textbf{Assets} - \textbf{Liabilities}$$

Figure 1. The primordial patrimonial equation

In accountancy, everything should be calculated from the firm's point of view. Therefore, in the equation mentioned above we take into account the firm's patrimony, the money, the goods, the receivables and the liabilities which all belong to the respective firm.

In accounting practice, Assets are represented by three main categories: Money, Economic Goods (Goods) and Receivables. Even if Assets are classified as *Non – current assets* and *Current Assets*, in the structure of these two categories we do not encounter anything besides Money, Goods and Receivables .

So, a simpler equation of Patrimony could be extracted from the more extended equation mentioned above: Net Patrimony = Assets – Liabilities or Assets = Net Patrimony + Liabilities.

It is known that, in accountancy, the Net Patrimony of a firm is also called Owner's Equity. If we replace it in the equation stated above, we obtain: Assets = Owner's Equity + Liabilities (the accountancy fundamental equation).

Owner's Equity in Romania is defined as being „*the interest of shareholders in the assets of an entity after the deduction of all its debts".* This is correct; however this definition is not established from the *firm*'s point of view, but from the *shareholders'* perspective. This issue creates a lot of confusion even among teachers with experience. We noticed this working as a teacher, which made me write this article in order to clarify once and for all what Luca Paciolo wanted to say a long time ago, but not everybody understood him correctly. So, the shareholders' interest represents in fact the shareholders' receivables toward their firm. But, from the firm's point of view, this means the firm's debt toward the shareholders, which we called at the beginning of this article Internal Debt. So, for the Owner's Equity we can use the term Internal Debts (namely the firm's debts toward its *shareholders*).

The notion of Debts from the equation mentioned above represents in fact the firm's Debts toward other persons (meaning toward any other persons except the shareholders). These Debts have been called at the beginning of this article External Debts (meaning the firm's debts toward other persons).

Therefore, replacing in the last formula mentioned above the Owner's Equity with the *Internal Debts* and the Liabilities with the *External Debts*, we will have the following new equation: Assets = Internal Debts + External Debts, meaning: Assets = Total Debts.

Combining this equation, namely Assets = Total Debts, with the patrimonial simple equation Assets = Owner's Equity + Liabilities, we can conclude that the Owner's Equity + Liabilities represent the firm's Total Debts. Or, in other words, all the OWNER'S EQUITY and LIABILITIES accounts are only DEBTS, which can be of two types: *Internal Debts* and *External Debts*.

Therefore, just as this patrimonial equation, A = E + L, was established a long time ago under the form Wealth = Capital, by I. N. Evian in his book *Double accountancy*, published in Bucharest in 1946 or under the form Wealth = Funds, by V. M. Ioachim in his book *Accountancy treatise*, Volume I, Bucharest, 1955, now, after more than half a century, we boldly confirm and sustain the same formula A = E + L, but under a new, different form, namely: Wealth = Debts.

What does this mean? Only that *everything I have* as a firm, is in fact what I *have to give*. This is normal, because when the firm was established, everything began from the formula Assets = Liabilities = 0. Then, everything that the firm will receive in Assets from shareholders or other persons, will appear in Owner's Equity and Liabilities as the firm's debt toward them. Therefore, everything that the firm receives, represents a debt, meaning Wealth = Debts, and this is how the permanent equality of the accountancy fundamental equation A = E + L is explained. From practice we also noticed that all the OWNER'S EQUITY and LIABILITIES accounts are in fact NAMES for the Assets accounts. Or, in other words: all the OWNER'S EQUITY and LIABILITIES accounts are NAMES for the Assets accounts.

This is why the *Amortization* is close to the *Owner's Equity and Liabilities*: the *Amortization* represents the name from the Owner's Equity and Liabilities for the *expenses* which have to be shown in the Assets. This is why the *Provisions / Adjustments* are close to *Owner's Equity and Liabilities*: the *Provisions / Adjustments* represent the name from the Owner's Equity and Liabilities for the *expenses* which have to be shown in the Assets, etc.

But a drawing is worth more than a thousand explanations, so here is a very suggestive draft, in Figure 2, which supports the assumption mentioned above:

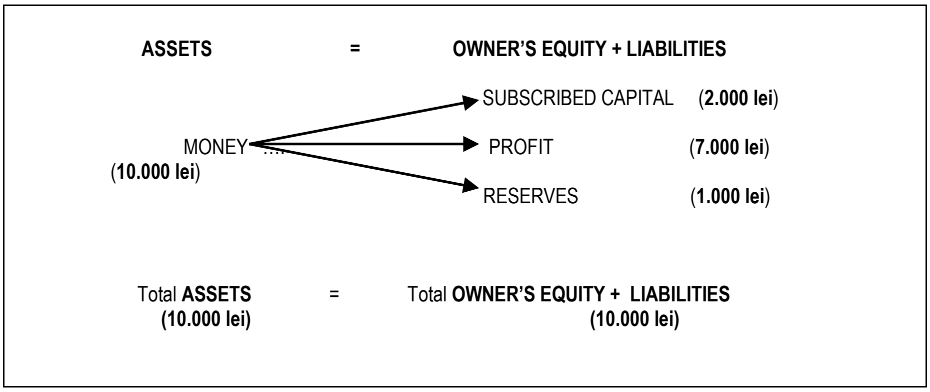

Figure 2. A model of the basic equation of the accounting

The next explanations follow this above Figure 2:

- the firm has 2.000 lei MONEY in *Assets* which is called SUBSCRIBED CAPITAL in *Owner's Equity and Liabilities,* with a value of 2.000 lei; at the same time, *the Subscribed Capital* represents the firm's *debt* toward its shareholders;
- the firm has 7.000 lei MONEY in *Assets* which is called PROFIT in *Owner's Equity and Liabilities,* with a value of 7.000 lei; at the same time, the *Profit* represents the firm's *debt* toward its shareholders;
- the firm has 1.000 lei MONEY in *Assets* which is called RESERVES in *Owner's Equity and Liabilities,* with a value of 1.000 lei; at the same time, the *Reserves* represent the firm's *debt* toward its shareholders.

To sum up, it is normal for the name from the Liabilities to be equal with what it represents in Assets and so, *the total value of EVERYTHING I HAVE in Assets should be equal with the total value of the NAMES from the Owner's Equity and Liabilities.* This is the second explanation of the equality A = E + L.

5. Conclusion

From what we have presented in this article, it is understood not that we changed the patrimonial equation, namely the basic accountancy equation A = E + L, but that this equation can also be viewed and interpreted in other ways than the literature has shown. We have presented it from another point of view and shown that it can be regarded from another perspective, just as other authors have tried to present it, but without drawing conclusions concerning these ideas.

We have tried to present this equation in a more simplified manner and to show how easy to understand is this brilliant duality created a long time ago by Luca Paciolo – the founding father of double entry accountancy. We know that it won't be easy to convince everybody at once of what we have presented. But as long as great personalities of accountancy agreed with us concerning the content of this article and encouraged us to publish it, we considered that the results of our research will become a starting point for many student-book authors from now on.

When I made this paper, I studied all the recent scientific literature from my country and a lot of international scientific researches. All that I remarked and I proved in this paper is based on the accountancy accepted all over the world.

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