Approaches and Developments Regarding the Recognition and Evaluation of Property, Plant and Equipment. The Impairment Test

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Abstract. The general accounting IASB framework for preparing and presenting financial statements sets the reference accounting model based on the recoverable historical cost and on the concept of nominal financial capital maintenance.

Going back to the regulations of the IAS, after recognition, a tangible asset can be measured and recorded in the accounts by choosing between two models – the model for determining the cost, and the revaluation model – following the permissiveness of the IAS.

Accounting must be at the same time normative (regulatory), meaning what must be (see the norms), positive, meaning what is (see the specific practices) and constructive, what isn’t (see synchronic and diachronic).

Standards are necessary to bring more uniformity in the accounting records. A global accounting requires rigid standards.

Keywords: impairment, depreciation, recoverable amount, fair value, cost model and revaluation model, depreciation test.

INTRODUCTION

The general accounting IASB framework for preparing and presenting financial statements sets the reference accounting model based on the recoverable historical cost and on the concept of nominal financial capital maintenance. It represents a general pattern that calls to search for other models and concepts, which could be better adapted to meet the objective of providing useful information in making economic decisions, but at this time, no common ground for making changes was found. This framework was created so that it can be applied to a range of accounting models and concepts of capital and capital maintenance.

The same general framework states that, “choosing the evaluation bases and the concept of capital maintenance determines the accounting model used for preparing financial statements. Different accounting models have varying degrees of relevance and credibility, like in other areas, the management must seek a balance between relevance and credibility.” In order for assertion to mobilize to professional judgment, the same general framework excuses itself throughout the fact that the IASB “has no intention to prescribe a certain model, from the different models, except for special cases such as those companies reporting in the currency of a hyper-inflationary economy. However, regarding global developments, this intention shall be revised.”

MATERIALS AND METHODS

Going back to the regulations of the International Accounting Standards, after recognition, a tangible asset can be measured and recorded in the accounts by choosing
between two models – the model for determining the cost, and the revaluation model – following the permissiveness of the International Accounting Standards.

The Standards do not choose between one of the two models, leaving the choice up to the company. Under the cost model, after recognizing an element as a component of tangible assets, it will be recorded at its cost less any accumulated depreciation and any accumulated impairment losses. The revaluation model considers that after recognition as an asset, a property, plant and equipment element, whose fair value can be measured reliably shall be recorded at a revalued amount, this being its fair value at the date of revaluation less any subsequent accumulated depreciation and any accumulated impairment losses.

RESULTS AND DISCUSSION

International Financial Reporting Standards deal with depreciation issues differently; the term depreciated value was introduced (deprived value) with another meaning than the usual Romanian practice. It is prescribed as necessary to reflect an asset in the financial statements at an amount not to exceed its recoverable amount obtained from the use or trading in an active market. The concept was developed precisely to ensure a better and reliable reflection of the asset’s value at the balance sheet date, in the financial statements of the entity. This is because, in practice, in many European jurisdictions, although there were statutory obligations to compare the accounting value of the assets with their market value, the requirements were not necessary applied rigorously. Furthermore, certain jurisdictions, particularly those with British legal-commercial tradition, did not require reflecting the depreciation, unless it was done permanently and on long term. The more rigorous approach of IAS 36 reflects the fact that regulatory authorities have become aware that this was a neglected area in financial reporting.

Thus, on balance, in accordance with IAS 36 – the accounting value of the asset is being compared with the fair value and the present value of estimated cash flows to be generated by use – use value. If the higher one of these future values is less than the accounting value, an impairment is to be recognized for the difference between them. The purpose of the legislation mentioned above is to prescribe all procedures that an entity applies, in order to ensure that its assets are not recorded at an amount greater than their recoverable amount.

An enterprise has two obvious ways to recover the value of its assets:
- by use or by market capitalization.

If the use value is lower than the one obtained on the market, a competitive entity would prefer to sell the asset than to use it, and vice versa. Therefore, in the spirit of IAS 36 “Impairment of assets”, the recoverable amount represents the maximum between the fair value less costs to sell the asset and its value for use; in other terms, the recoverable amount is the amount the entity expects to recover from future use of an asset, including its residual value upon disposal.

From the regulations of IAS 36 “Impairment of assets” emerges that its purpose is to prescribe all procedures that an enterprise must apply to ensure that its assets are not recorded at an amount greater than their recoverable amount.

To achieve the mentioned objective, one must follow the following steps:
A. Setting the impairment value and identifying the assets that could be depreciated;
B. Applying the impairment test and evaluating the recoverable amount;
C. Recognition and allocation of impairment loss.
Schematically, the steps listed are displayed below:

A. Setting the depreciation value

Identification of individual assets that could be depreciated or cash-generating units

Evidence, sources of a possible depreciation

YES

Stage B

NO

Stop

B. Application of the impairment test and evaluating the recoverable amount

Maximum between

Determining recoverable amount

Net fair value

Use value

Net accounting value > recoverable amount

DA

Stage C

NU

Stop

C. Impairment loss recognition and allocation

Impairment loss = net accounting value less recoverable amount

Step 1: Allocation of depreciation loss on the goodwill (if any exists and is associated to the asset analyzed)

Step 2: Allocation of excess loss, on the goodwill, over other identifiable activities, in proportion to the accounting value of every asset

Revalued assets

Non-revalued assets

It is recognized as a decrease of the revaluation reserve measured before for the analyzed asset, any excess is recognized in the profit and loss account

Recognition in the profit and loss account
CONCLUSIONS

Approaching the depreciation value issue, in terms of international regulations encourages a new vision in accounting; before harmonizing the Romanian accounting with the International Financial Reporting Standards and the European Directives, the definitive, irreversible concept of depreciation was pictured throughout the depreciation, while the reversible, temporary structure, throughout provisions for impairment of assets, evaluation at the end of the year was based more on the quantitative than the qualitative side, with the adoption of international regulations, assets are being recognized and evaluated according to their usefulness for the business, quantifying their contribution in connection to future economic benefits, a good can not be recorded in the balance sheet at a higher value than the recoverable amount – this produces great changes in traditional accounting, which must be restated and reconsidered, according to this view the accounting objective is to deepen and to consider the future, in order to be able to translate it into the financial statements. Standards have introduced and treated new concepts, if we were only to refer to the recoverable amount, its measuring requires modelling and information based on the companies own estimates, difficult to sustain and complex in application. And even if the company can call the evaluators help when measuring such structures, the modelling and quantification of such aggregates is under the impact of subjectivity and uncertainty, but also the cost-benefits constraints.

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REFERENCES


