

CONTINENTAL AND INTERNATIONAL NORMALIZATION OF ASSET IMPAIRMENT

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Abstract:

This paper introduces a comparative approach of accounting regulations regarding the impairment of assets under the standards in our country and according to International Financial Reporting Standards. Impairment is the loss of an asset's value reported during a year, due to specific factors that make the net selling price or the replacement cost lower than the book value. The size of impairment is rendered by the difference between book value and stock value. There are differences between the impairment of assets as perceived in the Romanian theory and practice, and the devaluation in terms of international rules.

As regards adjustments for impairment, at first sight they are similar to cases of asset devaluation. Although the final effect is the same, reducing the value of assets, the devaluation according to IFRS refers to damage with few chances of disappearing in the future, whereas adjustments for impairment in the sense of Ordinance of the Public Finance Minister 1802/2014 envisage a reversible impairment.

Key Words: national regulations, IFRS, assets, impairment, value adjustments.

JEL Classification: M41

1. Introduction

Assets are included in an enterprise in a material or non-material form. Physical form is not essential to the existence of an asset, that is why patents and copyrights are assets if they are expected to generate future economic benefits to the enterprise and if they are controlled by the latter. The International Accounting Standards Committee (IASC) has an economic (dynamic) vision, not a static (patrimony) one, admitting that the recognition of assets must not be exclusively linked to the legal rights the enterprise has on them. Ownership right is not essential to decide the existence of an asset. Although an enterprise's capacity to control benefits is usually the result of legal rights, one item can achieve the definition of an asset even without any legal control (for example, the case of know-how).

In support of the statement according to which the recognition of assets does not depend on their physical form or ownership right, one can mention *International Accounting Standards (IAS), IAS 17 on "Leasing" and IAS 38 on "Intangible Assets"* which require: entering the goods financed by a financial leasing agreement as assets (IAS 17) and reporting as assets the intangible assets if they are likely to generate future economic benefits and the cost of such assets can be measured reliably (IAS 38).

2. Contents

When defining and recognizing assets according to international norms, one starts with two criteria: future economic benefits and reliable assessment.

In order to demonstrate that an element meets the *former recognition criterion* to consider assets, an enterprise must assess the reasonableness of the flow of future economic benefits on the basis of the evidence available at the time of the initial accounting. The existence of sufficient certainty is proven by an enterprise's ensuring to obtain advantages attachable to the respective asset and by the fact that the enterprise shall assume the risks associated with an asset. In general, such insurance will exist only when the risks and advantages have been transferred to the enterprise.

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The *latter recognition criterion*, reliable measurement of an asset cost, is more easily achieved because in the event of procurement, one knows the procurement price, or the expenses generated by the procurement are clearly identifiable. If assets are obtained from own production, the cost reliable assessment can be performed starting from transactions with third parties to acquire raw materials, employ personnel, use employed labour force, other inputs made in the production process generating costs.

The two criteria for assets' recognition are nuanced in practice depending on the asset category. The recognition of assets may take peculiarities in some national concepts:

In the USA, assets are “probable future economic benefits obtained or controlled by an entity as a result of past transactions or events”. American normalizers do not link the recognition of assets to the existence of ownership right or the legal protection thereof.

In France, assets are “any patrimony element that has a positive economic value to an enterprise”. The French vision about patrimony bears the legal mark on this concept and, consequently, excludes the goods financed by a financial leasing agreement from assets. As it can be seen, the fundamental question arising on the recognition of an element as an asset element in the balance sheet or as an expense element in the profit and loss account is related to ownership right and its attributes: disposal right, using right, usufruct right.

In Romania, based on the Accounting Law, the principle of property in individual accounts is applied. According to the General Framework for preparing and presenting financial statements prepared by the IASC quoted by Romanian normalizers by Ordinance of Public Finance Minister 1802/2014, the “substance over form” principle is applied.

Being characterized by their expression in money, enterprise assets are more or less subject to impairment as time goes by. The impairment of assets is reported in accounting by means of corrective values such as depreciation and adjustments for asset impairment. The synthesis structure of assets subject to impairment is shown in the following table (Table no.1).

Table no. 1. Enterprise Assets Subject to Depreciation

Asset categories	Gross values	Corrective values
FIXED ASSETS	<ul style="list-style-type: none"> - intangible assets - tangible assets - assets in process - capital assets 	<ul style="list-style-type: none"> - depreciations - adjustments
CURRENT ASSETS	<ul style="list-style-type: none"> - stocks - receivables - treasury 	<ul style="list-style-type: none"> - adjustments

The effect of asset impairment has required for a proper accounting evaluation the issue of finding the mechanisms able to reduce, if possible cancel, the distortion related to historical cost. Maintaining a historical cost as evaluation basis, certain remedies and alternatives have been found. Remedies have materialized in the form of depreciations and adjustments for asset impairment, and alternatives have found their expression in their re-evaluation.

Specification. Impairment as depreciations and adjustments is approached in this paper in accordance with the accounting regulations stipulated in Ordinance of Public Finance Minister 1802/2014. According to the International Accounting Standards, depreciation is not seen as impairment, and asset impairment is treated as value adjustment.

In accordance with the accounting regulations stipulated by OPFM 1802/2014 and the approaches in specialized literature, there are two forms of impairment in our country's terminology:

Irreversible impairments are specific to tangible and intangible assets and are due both to physical damage or obsolescence, and to other causes. Impairment is considered by comparing the original cost of assets with the inventory value at tax year end. The addition

differences between the inventory value and the original cost in principle are not reported in the accounts, as such elements remain at their original costs. *The negative differences are reported in accounting as related to depreciation, and assets remain reported at their original costs* (book value or historical cost).

Reversible impairments mean the possibility that in future periods, the fixed (intangible, tangible, in progress and capital) assets and current assets could face a decrease in their market value (the potential recovery price may be lower). Such impairment is estimated at tax year end during inventory, so by calculation one can make a true assessment of an asset in the balance sheet. As a result, *these impairments are not definitive and therefore there are adjustments for them, and assets (as previously) remain at their original costs.*

Both depreciations and adjustments fulfil the role of reserves similar to sources, which yet generate certain expenses assimilated to assets and adversely affect the financial results of the respective tax year or reporting period. The two distinct types of expenses are: expenses for asset depreciation that are specific only to the fixed assets falling under physical damage and/or obsolescence, and expenses for asset adjustment which can be found in all categories of assets.

In accordance with the International Accounting Standards, value impairment is treated differently. It is “a loss of value occurring during the useful life of an asset, due to specific factors that make the net selling price or replacement cost lower than the net book value” (IFRS – International Financial Reporting Standards, 2015 p.A1187)

The size of impairment is rendered by the difference between the net book value and the inventory value. The latter takes different forms depending on the category of assets: recoverable value for tangible and intangible assets; net achievable value for inventories; probable value to be cashed for receivables, stock value for short-term financial investment.

Reflecting the loss of value in accounting, according to the IAS, is as per the expenses for asset impairment and crediting the account for an impaired asset, in order to highlight the direct influence of value decrease. Assets are to be reported at their new value both in the balance sheet, and in the primary records.

The above may lead to the conclusion that there are certain differences between asset impairment as it is perceived in the Romanian theory and practice, and value impairment in terms of the International Accounting Standards.

Depreciation as a form of irreversible impairment means the systematic allocation of the depreciable amount of an asset over its entire useful life. In other words, it is a gradual shift to costs of the asset original cost. Therefore, depreciation clarifies the implementation of the accrual accounting convention and of the principle of linking expenses to the period revenues.

In the spirit of international standard IAS 16 “Tangible assets”, an asset original cost is allocated to the expenses in the period, proportional to obtaining estimated future economic benefits. Thus, depreciation is not impairment, but allocating the original cost in order to connect the economic benefits generated by the asset with the efforts to own the latter rather than an asset assessment.

Adjustments for asset impairment as a form of reversible impairment envisages the non-depreciable asset whose inventory value at tax year end is lower than the original book value. Decreasing the value is reversible, therefore their value should be adjusted accordingly upon the clearance of accounts.

Value impairment relates to the value decrease of an asset, a deterioration that is unlikely to disappear in the future because of the obsolescence of adverse market conditions. Acknowledging by directly crediting an impaired asset account reveals that practically value impairment is related to assessment methods.

The value impairments of assets are not “covered” by assets’ depreciation. Value impairment is a loss of value occurring during the useful life of an asset due to specific factors that make the selling price or replacement cost lower than the net book value. Therefore, in

order to reach the quantification of value impairment, one must first know the size of cumulated depreciation and then adjust the original cost.

Generally, an asset is purchased for use during a long period of time in an enterprise and for generating future economic benefits; value impairment mainly occurs when the originally estimated economic benefits no longer meet expectations. In fact, it is not (only) “covering” the costs with the respective asset, but it is that economic benefits have another evolution than originally predicted.

Apparently, the value impairment of assets versus the depreciation and adjustments for asset impairment seem to have the same meaning. Although both refer to the decrease in an asset book value, how they are decided versus economic, tax and accounting effects are different things.

Concerning adjustments for impairment, at first sight they are similar to the cases of asset impairment, as described in *IAS 36 “Impairment of assets”*. Although the final effect is the same: decreasing the value of assets, value impairment in the sense of the IAS refers to a deterioration with little chance of disappearing in the future, whereas adjustments for impairment target reversible impairment.

In conclusion, it should be noted that the concepts of depreciation, adjustment for impairment, value impairment are used to directly or indirectly adjust the values of assets. They must be treated fairly, as they have specific causes and implications both in accounting research and in the calculation of various financial indicators of assets.

Among the IAS’s normalizing asset impairment, one can mention: *IAS 36 “Impairment of assets”*, *IAS 16 “Property, plant and equipment”*, *IAS 38 “Intangible assets”*, *IAS 2 “Inventories”*, *IAS 39 “Financial instruments: recognition and measurement”*.

IAS 36 “Impairment of assets” refers to the impairment of tangible and intangible assets. The standard states that an enterprise must estimate in the end of each tax year whether an asset is impaired on the basis of internal and external indices. The objective of the Standard is to prescribe the procedures that an entity applies to ensure that its assets are registered at a value exceeding or equal to its recoverable value. An asset is registered as being lower than its recoverable value if its book value exceeds the amount to be recovered through the use or sale of the asset. Under such a circumstance, the asset is described as impaired and the Standard requires the entity to recognize a loss from impairment. The Standard also stipulates when an enterprise must reverse an impairment loss and recommends the disclosure of certain information related to deteriorated assets.

IAS 16 “Property, plant and equipment” refers to the depreciation of tangible assets. The Standard states that the depreciable value is decided by subtracting the estimated residual value from the asset book value. In order to decide the depreciation related to a tangible asset, the enterprise shall decide the depreciation method and estimate the useful life.

The calculation of depreciation for an interim period relies only on the assets held during the period. One shall not take into account the assets acquired or asset outflows planned for a subsequent period of the financial year.

IAS 38 “Intangible assets” clarifies the definition and treatment of intangible assets that are not dealt with specifically in another International Accounting Standard. The Standard aims at the peculiarities regarding the depreciation of intangible assets. An enterprise, based on professional judgment, decides the depreciation period which must coincide with the best estimate of the asset’s useful life, not exceeding twenty years. The depreciation method must reflect how the economic benefits associated to the asset are consumed by the enterprise. If this orientation is not possible, the straight line method shall be used.

IAS 2 “Inventories” - in the case of inventories, one can refer to a constant value impairment when the cost exceeds the net achievable value and the proceedings shall bring the inventory to the latter value. In order to decide the net achievable value, one considers the

most reliable evidence of price and cost fluctuations, the destination for which the inventories are held, the potential damage or obsolescence level of inventories etc.

International practice diminishes an inventory for an acknowledged impairment through an account “Losses from the impairment of inventory value”.

According to *IAS 39 “Financial instruments: recognition and measurement”*, reporting financial assets is done according to the general framework for recognizing assets and stands out at their original book value (acquisition cost plus acquisition costs for financial instruments held till maturity). In order to prepare annual financial statements, the financial instruments shall be evaluated upon inventory. For the financial instruments meant for trading and available for sale, evaluation is made at their fair value and the plus or minus differences to the entry book value shall directly affect the financial asset account in accordance with the expense or revenue accounts (if applicable). For the financial instruments classified as those held till maturity, they are evaluated at their depreciated cost and the plus or minus differences to the book value shall generate expenses or revenues (if applicable).

In conclusion, in the sense of the IAS, concerning tangible and intangible assets, value impairment must first be located in time. Only if there are internal or external indices will an enterprise start testing an asset upon impairment. Professional judgment will decide the materiality threshold for considering an asset impairment.

From the accounting perspective, registering the value impairment can generate debiting an expense account or a reserve account from re-evaluating crediting the account (direct reduction) for the respective asset or goodwill.

The value impairments of assets are not “covered” by their depreciation. Thus, depreciation is the allocation (passing to costs) of the original cost to connect the economic benefits generated by an asset with the efforts to own it rather than an asset evaluation. Registering depreciation generates debiting an expense account in correspondence with crediting the depreciation account for an asset.

For the remaining assets, IAS norms see impairment as an “asset value decrease, reported as an expense in correspondence with the active account whose impairment has been found”. Moving on the period’s expenses is done according to professional judgment.

At regional level, the representative example is the accounting harmonization process carried out at EU level by means of directives. The scope and characteristics of European Directives are confined to the area of EU member states and their application is mandatory as they are a source of accounting law.

Directive 2013/34/EU of the European Union brings clarifications on asset impairment: decreasing the value of an asset resulting from causes whose effect is not judged definitively leads to acknowledging an impairment adjustment. If the current value of an asset falls below its net book value and the impairment is final, the object is subject to exceptional depreciation for the difference between the net book value and its present value. The present value is set using the references and techniques appropriate to the nature of the object.

At national level, national or local standards are prepared by each country in relation to international standards and European Directives. In our country, normalization is the static type. At the accounting level, there is an attempt to combine the current accounting legislation with international regulations. Thus, the legislative framework on accounting currently has three major components, namely:

- general accounting legislation;
- accounting legislation compliant with European accounting.

Depending on the needs of accounting information users, there has been a distinction between companies tradable on the stock market, companies/national companies and other nationally important legal persons compared to other trading companies, small and medium enterprises and respectively, microenterprises. The accounting harmonization programme in

Romania wants financial-accounting information to get a “commercial image in order to be provided to potentially interested investors”. The most important consequence of the programme is that it opens the way for the accounting profession to become popular in Romania.

Although the current regulations help in an attempt to comply the Romanian accounting with international standards, it is believed that regarding asset impairment starting from the assets’ evaluation until removing them from exploitation, there are still many issues to deal with (Table no. 2).

Table no. 2. Main Differences and Controversies Regarding Asset Impairment

Selected issues	IAS	Current Romanian legislation
<ul style="list-style-type: none"> ● Recognition of fixed assets 	<ul style="list-style-type: none"> ● as per the criterion of usefulness for more than a year. 	<ul style="list-style-type: none"> ● according to legal provisions, the value exceeding 2,500 lei and useful life more than one year.
<ul style="list-style-type: none"> ● Asset impairment 	<ul style="list-style-type: none"> ● acknowledging impairment is based on internal and external indices; ● acknowledging impairment is in the form of value impairment; ● fixed assets must be impaired until the level of net achievable value. 	<ul style="list-style-type: none"> ● acknowledging impairment is done when the present value falls below the net book value: <ul style="list-style-type: none"> - temporary (reversible) and impairment adjustments are set; - definitive (irreversible) and is subject to depreciation; ● fixed assets are depreciated throughout their normal operating period, and while deciding the impairment, the role of independent evaluators must be considered.
<ul style="list-style-type: none"> ● Depreciation 	<ul style="list-style-type: none"> ● is allocating the depreciable amount of an asset all throughout its estimated useful life; ● the depreciable amount is the historical cost (or the amount set in financial statements) reduced by the estimated residual value. 	<ul style="list-style-type: none"> ● is set by applying the depreciation rates upon the asset entry value; ● is calculated based on a depreciation from the date of commissioning until full recovery of their entry value, according to their duration and conditions of use.
<ul style="list-style-type: none"> ● Re-evaluation 	<ul style="list-style-type: none"> ● performed whenever necessary (professional judgment). 	<ul style="list-style-type: none"> ● performed whenever necessary (professional judgment, in conjunction with company policies and tax regulations)
<ul style="list-style-type: none"> ● Making up adjustments for asset impairment 	<ul style="list-style-type: none"> ● believes impairment as a decrease of asset value, registered as an expense in correspondence with the impaired asset account. 	<ul style="list-style-type: none"> ● believes reversible impairments as being an expense in correspondence with the adjustment account for asset impairment.

3. Conclusions

In this paper, the authors have tried to introduce significant elements of asset impairment according to national and international accounting regulations.

In an economy disconnected from taxes, the accounting policy adopted by an company can more easily meet the provision of true and concrete information which by certification is credible for all users and, according to the fundamental objective of accounting, it should meet the need for truth.

In regulated accounting, accounting policies and procedures are based both on accounting principles and on the system of normative regulations. The reference system for developing accounting policies accepts alternatives for registering and evaluating in accounting, or different evaluation and calculation methods of the financial status, financial outcome and financial statement.

Registering the impairment of assets may represent a conflict of interests given the management and tax interests, with repercussions upon the true and fair view. Accordingly, based on the limits of accounting principles/conventions, accounting information producers

may resort to various ways of “shaping” a financial status and accounting result until “deforming” them.

However, accounting as a science, as an *art* in the economic decision-making process, enables one within the legal limits to choose the version that best meets the interests of a company, without affecting the objective of achieving “a true fair view” of the financial status, financial position, and profit and loss account. At the same time, among the tax mechanisms that public authorities resort to for inciting or inhibiting business operators, taxation provides those based on deductible expenses, instruments widespread in the world.

In terms of acknowledging an impairment of its assets according to the irreversible or reversible form, based on accounting principles/conventions and the legislative regulations in force, an enterprise must set its accounting policy that best meets its interests.

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