

# Reversible Depreciation of Property, Plant and Equipment - Tax Implications vs. Ensuring the Quality of the Accounting Information

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*Abstract: In this paper, the reversible depreciation of the tangible fixed assets is addressed to the companies applying the provisions of Order of the Minister of Public Finance 1802/2014 for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated annual financial statements. Also, the need to recognize the adjustments for the depreciation of tangible fixed assets is highlighted by analyzing, from the accounting and fiscal perspective, the impact on the indicators in the balance sheet and the profit and loss account. The importance of the accounting information regarding the adjustments for the depreciation of the tangible fixed assets in the management, investment and lending decisions, is a topic of this work.*

*Key words: accounting information, users of accounting information, reversible depreciation of the intangible assets, the result of the financial year, taxable result*

## 1. Introduction

Accounting information has an important role in carrying out the activity of an economic entity. The accounting quantifies the economic activities, recording the data regarding them for future use, stores them as long as necessary, and then processes them and communicates them to the decision makers. [1] In order to assist users in making decisions, accounting information must be relevant and represent what they intend to represent [2], that is, be complete, neutral, error free.

Accounting information is presented in the form of internal reports, intended for managers, or periodic reports intended for the general public, employees, customers, suppliers, creditors, investors, state authorities, known as financial statements.

The internal reports include information according to the information needs of the managers, while the information presented in the financial statements refers mainly to the financial position and the financial performance of the company, respectively to the value of assets, liabilities, equity and results obtained from the activity.

The information regarding the reversible depreciation of the coporal fixed assets influences both the indicators in the balance sheet regarding the tangible assets, as well as those in the profit and loss account regarding the operating result, the gross result of the year.

Of all the categories of users of accounting information, those whose decisions are largely influenced by the recognition in the accounting of an economic entity of the reversible depretiations of the tangible fixed assets are the managers, investors and creditors.

For investors, it is necessary to know the real value of the assets, liabilities, equity of a company, but especially the size of the net results obtained from carrying out the activity, which shows the entity's ability to pay dividends, respectively its ability to remunerate them. Investors need such information to decide whether they should buy, hold or sell equity instruments. [3]

The assets of an economic entity are the main instruments generating future economic benefits, by increasing the revenues or diminishing the expenses, their value influencing the capacity of an organization to carry out the activity and to obtain profit. Therefore, knowing the real value of the assets, especially the tangible assets, plays an important role in the management decisions.

The credit decision of a legal person assumes an analysis on the basis of the data in the financial statements and the balances of verification submitted by the applicants here shows the need for accounting information to be real, complete, neutral.

In the following, the impact of the recognition in the accounting of the economic entities that apply the provisions of Order of the Minister of Public Finance 1802/2014 for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated annual financial statements of the reversible depreciation of the tangible assets on the balance sheet and profit and loss account is treated, from both the accounting perspective and the tax perspective. Also, it is emphasized the importance of such information in decision making by managers, investors and creditors.

## 2. Reversible depreciation of property, plant and equipment - accounting issues

At the time of preparing the financial statements, the economic entities have the possibility to choose, through the accounting policies, the valuation of the tangible assets on the principle of the acquisition cost or of the production cost or to proceed to their revaluation.

If the entities choose to reassess the tangible assets, their value in the balance sheet is the fair value established by the authorized valuers, being a present value of the assets.

The economic entities that choose through the accounting policies the valuation of the tangible assets on the basis of the acquisition cost or the production cost principle, will present in the balance sheet such assets at its cost less any accumulated depreciation and any accumulated impairment losses.

Depreciation of tangible fixed assets shows a decrease in its value as a result of physical wear and tear, which will be recognized in accounting as amortization or as a result of moral wear and tear, which will be recognized in accounting as a reversible depreciation, called an adjustment for depreciation.

Reversible depreciation of the value of an intangible asset may be caused by the significant decrease in the market value of the asset; significant changes, with negative effect on the economic entity, of the technological, commercial, economic or legal environment in which they operate their activity or on the market where the asset is destined. Also, information from the internal reports of the economic entity may show the reversible decrease of the value of the tangible assets, such information regarding the degree or the way in which the fixed assets are used or expected to be used. The indices of depreciation of the fixed assets, made available by the internal reports, include: the cash flow required to purchase a similar fixed asset, for the operation or maintenance of the fixed assets is significantly higher than initially provided in the budget; the operating result generated by the tangible fixed assets is noticeably lower than that provided for in the budget; a significant decrease of the operating profit provided in the budget, respectively a significant increase of the losses foreseen in the budget, generated by the tangible fixed assets. [3]

Reversible depreciation of the value of a tangible asset is recorded in accounting on the basis of the expense accounts and those for adjustments for the depreciation of the tangible fixed assets.

The expenses regarding the adjustments for the depreciation of the fixed assets are operating expenses recorded in the accounting of the economic entity in the financial year in which it was found the reversible decrease of the value of the asset, thus it is influenced both the result of the operation and the gross result of the year.

The adjustments for the depreciation of the tangible fixed assets correct in the sense of diminishing their book value, and the resulting value is recognized in the balance sheet as the present value of the respective assets.

Therefore, the reversible decrease in the value of the tangible assets influences both the balance sheet indicators, reducing the value of the tangible fixed assets up to the present value, as well as the indicators in the profit and loss account that reflect the results of the operation and the gross result of the financial exercise.

To illustrate how the reversible depreciation of tangible assets affects the indicators presented in the financial statements we suppose that at the end of 2015 an economic entity purchased a technological equipment under the following conditions: acquisition cost 240,000 lei, useful life of the asset - 8 years, the method of depreciation - straight-line . The inventory at the end of 2018 shows that the inventory value of the asset is 140,000 lei, taking into account the technological evolution in the field. Other information necessary for carrying out the analysis regarding the impact of the recognition of the reversible depreciation of the value of the tangible assets on the indicators presented in the financial statements for 2018 can be found in the following table:

**Table 1**

Technological equipment acquisition cost	240,000 lei
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Useful life of the technological equipment	8 years
Depreciation method	straight-line
Accumulated depreciation form 2016 till 2018	90,000 lei
Carrying amount before the inventory in the year 2018	150,00 lei
Inventory value	140,000 lei
Impairment loss	10,000 lei
Equipment value presented in 2018 balance sheet	140,000 lei
Operating income	550,000 lei
Operating expenses, excluding impairment loss	450,000 lei
Amount of the impairment loss	10,000 lei
Operating result	90,000 lei
Financial result	-
The gross result of the exercise	90,000 lei

The principle of prudence requires that the valuation of the assets when preparing the financial statements should be done on a prudent basis and that all the depreciation of value in the amount of expenses be recognized, regardless of the impact on the result of the financial year.

The impact of the impairment loss of the technological equipment on the 2018th balance sheet indicators :  
Tabel 2

Indicator	Indicator value at the end of the year 2018 without acknowledging the impairment loss	Indicator value at the end of the year 2018 with acknowledging the impairment loss
Tangible fixed assets (technological equipment)	150,000	140,000

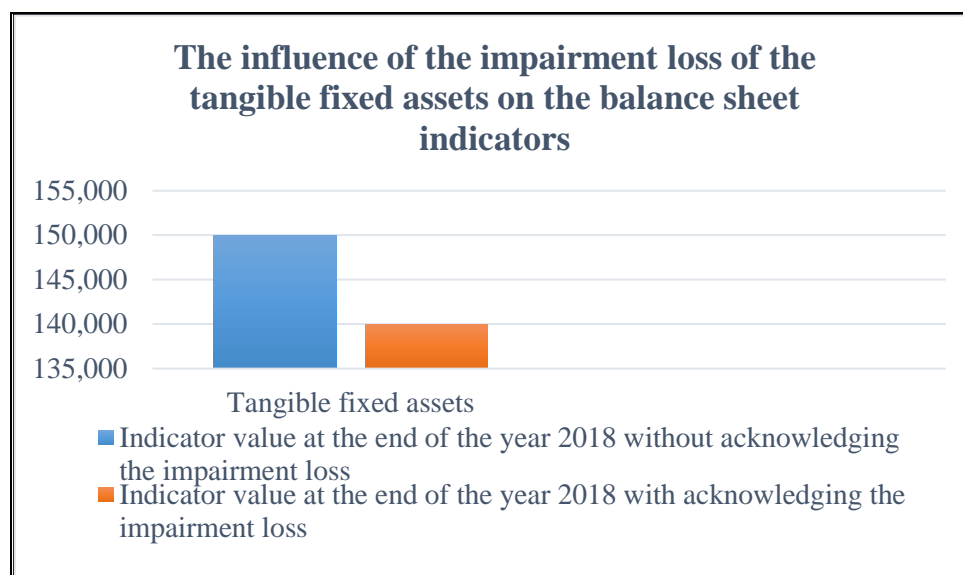


Fig. 1 The influence of the impairment loss of the tangible fixed assets on the balance sheet indicators

In case the reversible depreciation of the value of the technological equipment was not recognized in the accounting of the economic entity, the value of the tangible assets presented in the balance sheet would represent the good's cost corrected with the depreciation calculated from the moment of putting into operation up to 31 December 2018. The recognition of the reversible impairment of the value of the technological equipment will cause the value of the asset to decrease with the difference between the carrying amount before inventory and the inventory value. Therefore, the recognition of the reversible impairment of the value of the tangible assets will diminish the value of the goods in question presented in the balance sheet of 2018 and

implicitly of all the indicators of the statement to which the tangible assets are component, respectively total fixed assets and total assets minus current liabilities.

The impact of recognizing the impairment of the value of the technological equipment as operating expenses:

**Table 3**

Indicator	Indicator value at the end of the year 2018 without acknowledging the impairment loss	Indicator value at the end of the year 2018 with acknowledging the impairment loss
Operating income	550,000	550,000
Operating expenses	450,000	460,000
Operating result	100,000	90,000
Financial result	-	-
The gross result of the exercise	100,000	90,000

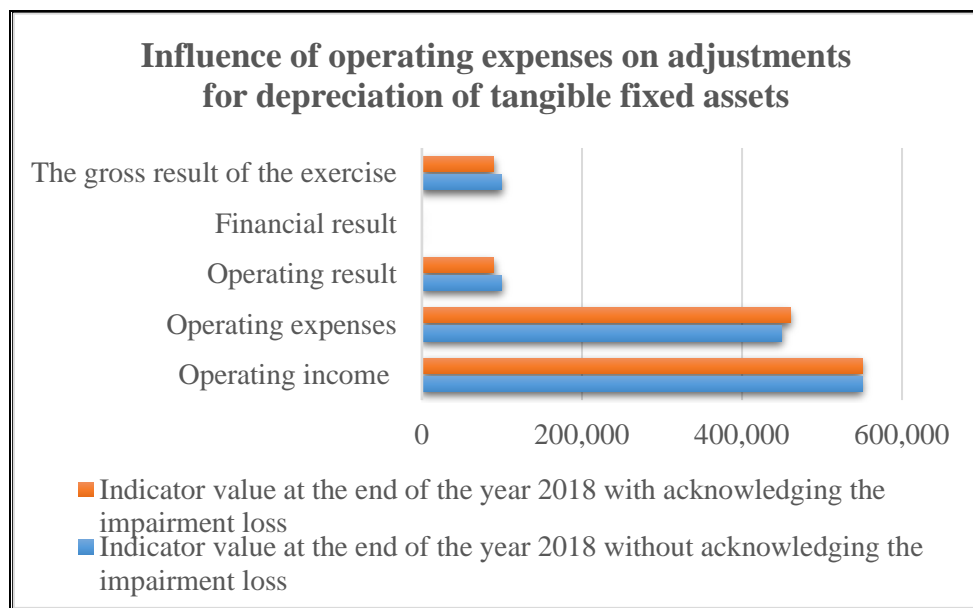


Fig. 2 The influence of the recognition of the reversible impairment of the value of the tangible fixed assets on the indicators in the profit and loss account

Analyzing the information presented in table 3, it appears that the recognition of the reversible impairment of the value of the technological equipment will increase the operating expenses and will diminish the operating result and the gross result of the financial year 2018.

If, when assessing the assets made at the inventory for the purpose of preparing the financial statements, there are indications that an impairment loss recognized in the previous financial years for a tangible asset no longer exists or has been reduced, the impairment adjustments of the tangible assets must be resumed at total or partial income. The information that shows the diminution or lack of depreciation of the value of the tangible assets has external and internal sources. Information from outside sources that would indicate a decrease in impairment loss can be as follows: the market value of the fixed assets increased significantly during the period; during the period significant changes have had a favorable effect on the entity or it is estimated that such changes will occur in the near future, in the technological, commercial, economic or legal environment in which the entity carries out its activity or on the market to which the asset is dedicated. [4] Information from an internal source that may show an increase in the value of the asset compared to the book value would be the following: during the period significant changes have taken place, with a favorable effect on the entity, or such changes will occur in the near future regarding the degree or how asset is used or expected to be used. These changes include the costs incurred during the period to improve and increase the performance of the fixed assets or to restructure the activity to which the fixed assets belong; internal reports prove that the economic performance of an asset is or will be better than originally envisaged, etc. [5]

The resumption of income from the impairment value of the intangible assets will determine the increase in operating income related to the financial year in which they are recognized in accounting as income from adjustments for the depreciation of the fixed assets. They will also determine the increase of the operating result and the gross result of the respective year.

Non-recognition of operating expenses regarding adjustments for depreciation of fixed assets in the accounting of an economic entity that has clear indications of depreciation of the value of the assets in question, besides that it would mean a violation of the principle of prudence, would mean a distortion of the accounting information regarding the real value of assets, of operating result and gross result of exercise. The real value of the mentioned indicators represents an informational basis for managers, creditors and investors in making decisions.

If the real value of a tangible asset is lower than the one presented in the financial statements, the asset will not generate the expected economic benefits, and during its useful life will lead to losses. Thus, if the managers do not know the real value of the assets held by the entity, they will not be able to make decisions either regarding the improvement of the functional parameters of the asset in order to increase the economic benefits generated by it, or regarding the replacement of the good with a more efficient one.

The creditors of an economic entity before granting the loan to the applicants carry out an analysis of their creditworthiness, having as a starting point the indicators in the balance sheet and their profit and loss account.

Therefore, the presentation of real values, established in compliance with the accounting principles, in the financial statements plays an important role in granting the loans, as well as for their recovery, respectively collecting the related interests.

Current and potential investors are analyzing the ability of the economic entity to generate profit and pay dividends. The size of the net profit is influenced by the size of the gross result of the year and of the tax due.

The result of the exercise depends on the recognition or non-recognition of the operating expenses regarding the adjustments for the depreciation of the fixed assets. The recognition in the accounting of the economic entity of the operating expenses regarding the adjustments for the depreciation of the fixed assets determines the diminution of this indicator in the year in which these adjustments are constituted and to its increase when the adjustments are diminished, respectively canceled by their restatement to operating income.

### 3. Reversible depreciation of property, plant and equipment - tax issues

Companies that carry out economic activities and fulfill the legal conditions from a fiscal point of view are tax payers or tax payers on the income of micro-enterprises. In both cases, the companies must determine a fiscal result /tax base, taking into account the provisions of the fiscal code, to which the related tax rate applies.

A. The influence of the recognition of the reversible impairment of the tangible assets on the fiscal result determined by the companies paying tax on profit

The fiscal result, determined by the companies paying tax on profit, is calculated as follows:

$$\text{Fiscal result} = \text{The gross result of the exercise} - \text{Non-taxable incomes} - \text{Tax deductions} + \text{Non-deductible expenses}$$

Non-taxable income includes, among other things, income from the cancellation of expenses for which no deduction was granted. Non-deductible expenses also include expenses with adjustments for the depreciation of depreciable fixed assets constituted for situations where they are not destroyed as a result of natural disasters or other causes of force majeure, under the conditions established by the rules of the tax code or for those that they have not signed insurance contracts. Considering the way of determining the fiscal result it is deduced that in the financial year in which the reversible impairments of the tangible assets are recognized in the operating expenses accounts, for the above example, the expenses with the adjustments for the depreciation of the fixed assets cancel the effect on the tax base, as shown in the following table:

**Table 4**

Indicator	Indicator value at the end of the year 2018 without acknowledging the impairment loss	Indicator value at the end of the year 2018 with acknowledging the impairment loss
The gross result of the exercise	100.000	90.000

Non-taxable incomes	-	-
Tax deductions	-	-
Non-deductible expenses	-	10.000
Fiscal result	100.000	100.000

In the financial year in which the adjustments will be resumed to the revenues from adjustments for the depreciation of the fixed assets, they will be, in the calculation of the fiscal result, both in the result of the year and in the category of non-taxable income, canceling their effect on the tax base.

B. The influence of the recognition of the reversible impairment of the tangible assets on the fiscal result determined by the companies paying tax on the income of the micro-enterprises

Companies paying tax on the income of micro-enterprises, take into account the taxable income of any source, from which they subtract:

- a) revenues related to the costs of product stocks;
- b) revenues related to the costs of running services;
- c) revenues from the production of tangible and intangible assets;
- d) subsidy revenues;
- e) income from provisions, adjustments for impairment or for loss of value, which were non-deductible expenses in the calculation of taxable profit or were constituted during the period when the Romanian legal entity was subject to the tax on the income of micro-enterprises;
- f) the revenues from adjustments for expected losses related to the financial assets constituted by the Romanian legal entities that carry out activities in the banking field, in the fields of insurance and reinsurance, of the capital market, which were non-deductible expenses when calculating the taxable profit or were constituted during the period in which the person Romanian legal entity was subject to tax on the income of micro-enterprises;
- g) the revenues resulting from the return or cancellation of interest and / or late penalties, which were non-deductible expenses when calculating taxable profit;
- h) the incomes obtained from damages, from the insurance / reinsurance companies, for the damages caused to the goods of the nature of the stocks or of the own tangible assets;
- i) income from exchange rate differences;
- j) the financial income related to the receivables and debts with settlement according to the exchange rate of a currency, resulting from their evaluation or settlement;
- k) the value of the commercial discounts granted after the invoicing, registered in the account 709 Commercial discounts granted, according to the applicable accounting regulations;
- l) the incomes related to the payment titles obtained by the persons entitled, according to the law, initial holders who are in the records of the Central Commission for the Settlement of Compensation or their legal heirs;
- m) compensation received based on the judgments of the European Court of Human Rights;
- n) the revenues obtained from a foreign state with which Romania has concluded a convention to avoid double taxation, if they were taxed in the foreign state.[6]

and to which adds the following:

- a) the value of the commercial discounts received after the invoicing, registered in the account 609 Commercial discounts received, according to the applicable accounting regulations;
- b) in the fourth quarter or the last quarter of the taxable period, in the case of taxpayers who cease to exist, the favorable difference between the exchange rate income / the financial income related to the receivables and debts settled according to the exchange rate of a currency, resulting from their assessment or settlement. , and the expenses due to exchange rate differences / related financial expenses, recorded cumulatively from the beginning of the year;
- c) reserves, except those representing tax facilities, reduced or canceled, representing the legal reserve, reserves from the reassessment of fixed assets, including land, which were deducted from the calculation of taxable profit and were not taxed during the period when the micro-enterprises were also paying by tax on profit, regardless of whether the reduction or cancellation is due to the change of the destination of the reserve, its distribution to participants in any form, liquidation, division, merger of the taxpayer or any other reason;
- d) reserves representing fiscal facilities, set up during the period in which the micro-enterprises were also tax payers, which are used to increase the share capital, to distribute to the participants in any form, to cover the

losses or for any other reason. If the tax reserves are maintained until liquidation, they are not taken into account to determine the taxable base as a result of the liquidation.[7]

Considering the way in which the tax base is determined by micro-enterprises, it follows that the recognition of the reversible depreciation of the tangible assets in the operating expenses of the company does not influence it in any way, they are not taken into account when calculating the tax base.

In the financial year in which the adjustments will be resumed to income from adjustments for depreciation of fixed assets, they will fall both in the income category from any source and in the income category that fall from the aforementioned, canceling their effect on the tax base.

The conclusion is that the recognition of the adjustments for the depreciation of the tangible fixed assets does not influence the tax base to the detriment of the companies paying tax on the profit or on the income of the micro-enterprises.

#### 4. Conclusions

The companies must present in the financial statements, in accordance with the principle of prudence, the tangible assets at their real value, respectively, they must take into account all the permanent and reversible impairments when determining it. The real value of the tangible assets plays an important role in the decisions of the managers, investors, creditors.

Managers need the information regarding the present value of the tangible assets because an impairment would mean a decrease of the future economic benefits resulting from the use of the asset, which during the years of using such assets would lead to losses.

The reversible impairment of the value of the tangible assets is recognized in the accounting of an economic entity as an operating expense in the financial year in which it is ascertained, thus influencing the result of the operation, the result of the exercise and implicitly the net result. The net result of the financial year is an indicator pursued by investors, its size providing them with information regarding the company's ability to make a profit and to pay dividends.

The creditors of an economic entity make the decision of granting loans by analyzing the information from the financial statements and from their balances, such information allowing them to determine the extent to which they will recover their financial resources and to collect the related interests.

The recognition of the reversible impairments of the tangible assets in the accounting of the economic entities, allows them to prepare credible financial statements, which will facilitate their access to loans for which they will have the capacity to repay and pay the interest. It will also allow managers to make decisions regarding the improvement of the functional parameters of the impaired assets or to replace the respective asset with a better one in order to avoid or reduce losses.

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