

Comparative Analysis Regarding the Recognition and Evaluation of Property, Plant and Equipment – IAS 16 vs. OMPF No. 1802/2014

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Abstract

Property, plant and equipment is present in any entity, regardless if it is a private or a state entity, their main objective being to provide benefits to the company. The right classification, depending on the company's line of business and the purpose for their use, is very important because it determines the applicable accounting treatment. The efficiency regarding the way these assets are recognized brings excess value to the entity, with a direct impact on the financial statements. The accountant's professional judgement used in choosing the accounting policies in order to ensure that those are the most relevant and that the accounting for is correct involves exigency and rigorous research, for a correct final result and a transparent image of the firm. Alternation of the accounting policies, as well as the alternation of the input values of property, plant and equipment can significantly influence the values recorded in the financial statements, as well as the financial position and performance.

The aim of this article is to highlight the main aspects related to the recognition and evaluation of property, plant and equipment according to the moment they enter the entity. Therefore, at the end of this research we will know the applicable accounting treatments as well as the main differences between the IAS 16 Property, Plant and Equipment and the Order of the Minister of Public Finance No. 1802/2014 for the approval of the Accounting regulations regarding the individual annual financial statements and consolidated annual financial statements, as subsequently amended and supplemented.

Key terms: IAS 16, OMPF No. 1802/2014, property, plant and equipment, cost, evaluation, input value, fair value

JEL Classification: M41, M48

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➔ Introduction

The careful evaluation and understanding of the accounting system minimize the possibility of errors, management deficiencies and fraud. Entities falling under the International Financial Reporting Standards are particularly important in the economic market. These are public interest entities because of the indicators achieved, as well as their social importance. Efforts have been made at a global level to improve the financial accounting communication, by ensuring transparency and by creating a solid business environment.

Numerous Romanian entities apply the accounting regulations consistent with the European directives established in the OMPF No. 1802/2014. This order includes accounting rules and treatments that are largely similar to the ones from the IFRSs, however, there are also differences regarding the accounting treatment.

In order for an economic entity to be efficient and provide a reasonable image of the property, plant and equipment held, as well as credibility for the financial statements, the recognition and evaluation of assets are mandatory. The importance of the recognition and evaluation of property, plant and equipment is recognized by the published literature, which also brings into discussion the practices that can be applied in their assessment. To mitigate the risks of recognizing a tangible asset in an inappropriate category, special attention must be paid to the purpose of the acquisition, as well as to the line of business chosen by the company. International regulations and practices allow us to choose the right category depending on the purpose. The main purpose of property, plant and equipment is to bring economic benefits to the entity for as long as possible, and they can be used both in the production activity, as well as for administrative purposes.

When recognizing property, plant and equipment, their cost is also brought into discussion, which could have different values depending on the origin of the asset and the way in which it is formed.

The differences between the Romanian legislation according to the OMPF No. 1802/2014 and IFRSs/IAS 16 will be discussed in this article because it is a matter of interest for both practitioners and academia. With the help of comparative practical examples, we will highlight the relevant aspects regarding the recognition and evaluation of property, plant and equipment and we will also make comments based on the discrepancies found. The identification of the applicable reference framework in the evaluation of these assets is critical because the values presented in the financial statements may differ. Accounting policies also have a fundamental role with repercussions on the image of the balance sheet as well as on the financial result and indicators.

➔ The purpose and the research methodology

The purpose of this research is to highlight the important aspects related to the recognition and evaluation of property, plant and equipment in accordance with IAS 16 so that at the end of this research we know the differences between the international standard and the OMPF No. 1802/2014.

The research methodology lies in a comparative analysis between the Romanian legislation on property, plant and equipment, namely the OMPF No. 1802/2014, and IAS 16. The research methods used are a qualitative one through documenting, observing, interpreting, explaining and understanding the procedures used and a comparative one, through practical examples applicable to the two effective accounting regulations.

Thus, the **main objectives** are:

- exploring the published literature regarding property, plant and equipment;
- the analysis of the implications of the professional judgement in the recognition and evaluation of property, plant and equipment;
- the determination of the impact of property, plant and equipment on financial statements;
- the presentation of conclusions.

The main research questions are linked to the objectives of the research:

- ✓ *What are the main differences between the Romanian and the international legislation in relation to the accounting for property, plant and equipment?*
- ✓ *What is the impact of these differences on financial statements?*

➔ The recognition of property, plant and equipment

Starting from the entry of property, plant and equipment into a company, they must receive the appropriate accounting treatment, depending on the necessity and duration of their use. The accounting professional shall implement his professional judgement and experience in such a way that compliance with the recognition criteria and all the effective legal provisions is ensured.

Property, plant and equipment includes land and landscaping, construction, technical installations and means of transport, animals and plantations, furniture, office equipment, equipment for the protection of human and material values, property, plant and equipment in progress.

Property, plant and equipment are recognized as assets of a company when they meet the following conditions:

- they are likely to generate future economic benefits to the entity related to the asset;
- the cost of the asset can be measured reliably.

Recognition of property, plant and equipment must be carried out with caution, exercising professional judgement so that all relevant circumstances are taken into account. The standard allows for the recognition of these assets on components if they are of significant value and meet the recognition criteria.

Both IAS 16 and the OMPF No. 1802/2014 require the recognition of assets which are used for a period of more than one year, but do not specify a value ceiling from which an asset can be classified as property, plant and equipment. Each entity should adopt accounting policies indicating the amount from which assets are recognized as property, plant and equipment. The Government Decision No. 276/2013 regarding the settlement of the input value for fixed assets sets the value of 2,500 lei as the book value of property, plant and equipment, this being used for tax purposes.

■ Property, plant and equipment consignment

According to the IFRSs, depending on the company's line of business and the purpose of their acquisition, property, plant and equipment may be accounted for in different ways, such as:

✓ Property, plant and equipment **purchased for use in the production activity, in the supply of goods or services or for administrative purposes** should be accounted for in accordance with IAS 16 *Property, Plant and Equipment*, in accounts 211 "Land and landscaping", 212 "Buildings" and 213 "Technological equipment (machinery, facilities and installations)".

✓ Property, plant and equipment **purchased for sale** should be accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, in account 311 "Fixed assets held for sale".

✓ Property, plant and equipment **purchased for the purpose of the development or construction of new dwellings for sale** should be accounted for in accordance with IAS 2 *Inventories*, in account 371 "Commodities".

✓ Property, plant and equipment **acquired to obtain rental income or to increase the value of capital** should be accounted for in accordance with IAS 40 *Investment Property*, in account 215 "Investment property".

The professional accountant must apply the professional judgement, carefully analyse each information so that property, plant and equipment are classified in the appropriate category. **The goal** is the main benchmark in their accounting. From the moment they enter the unit or during their use, their necessity in the current activity must be established. If they are used for administrative purposes, then they will be registered in the appropriate class. During their use, the purpose can be changed. Thus, the building used for administrative purposes can easily pass to the category of inventories or investment property. The only condition is finding the most appropriate accounting treatment in order to present a fair image of the firm, because its application can have a significant impact on the outcome and the financial statements.

Example 1

SC Mary SA acquires two pieces of land for the following purpose:

1. one piece of land worth 400,000 lei where the entity intends to build an administrative building;
2. one piece of land worth 200,000 lei where the entity intends to build a building comprising dwellings to be sold together with the land.

1. Land acquisition for administrative purposes	2111 "Land"	=	404 "Suppliers of fixed assets"	400,000 lei
2. Land acquisition for the purpose of building new dwellings for sale	371 "Commodities"	=	401 "Suppliers"	200,000 lei

Example 2

SC Mary SA, whose main line of business is the purchase and sale of buildings, acquires three buildings for the following purposes:

1. a building worth 350,000 lei for the purpose of renting it to third parties under an operational lease. The commission for the real estate agency was 10,000 lei, and the notary fees, 5,000 lei;
2. a building worth 400,000 lei for administrative purposes;
3. a building worth 500,000 lei.

1. Building acquisition for the purpose of renting	2152 "Investment property evaluated at cost"	=	404 "Suppliers of fixed assets"	365,000 lei
2. Building acquisition for administrative purposes	212 "Buildings"	=	404 "Suppliers of fixed assets"	400,000 lei
3. Building acquisition as commodity	371 "Commodities"	=	401 "Suppliers"	500,000 lei

As we can see, the actual state of the entity is rendered once the purpose of the use of the property, plant and equipment is identified (no. 1 and 2), as well as through giving the appropriate care to its line of business (no. 3). Investor decisions may be influenced by these amounts because they are substantial, as well as by the subsequent expenses which have repercussions on the financial result.

➔ The evaluation of property, plant and equipment

The evaluation is the process through which the value at which the items in the financial statements are recognized in the accounts and are shown in the balance sheet and in the profit and loss account. The entry of property, plant and equipment into an entity is made at different values according to their provenance, as follows:

- **the cost of purchase** – for goods purchased for consideration;
- **the cost of production** – for goods produced in the entity;
- **the contribution amount** – for the goods representing the contribution to the share capital, determined by an ANEVAR member value;
- **the fair value** – for goods obtained free of charge or plus inventory.

An important definition from IAS 16 is the definition of **cost**. It is necessary to determine the cost when the assets enter or exit the entity, on their acquisition or production. Thus, the **cost** represents:

- the amount in cash or cash equivalents;
- the fair value of another consideration given to acquire an asset at the date of its acquisition or construction;
- the amount attributed to that asset at initial recognition in accordance with the specific requirements of other IFRSs.

The main differences between Romanian accounting regulations and the IFRSs are related to the accounting policies applied in relation to the cost of acquisition, the cost of production and the fair value.

■ Cost of acquisition

The composition of the purchase cost is as follows:

- purchase price, including import duties and non-refundable purchase taxes, after deduction of trade discounts and rebates;
- costs relating to bringing the asset to the location and condition required for operation;
- initial estimated cost for disassembly and removal of the asset, restoration of the site where it is located.

According to OMPF No. 1802/2014, the reduction received after the purchase invoice is shown in the account 475 “Investment grants” and is resumed to income during the useful life of the asset as depreciation is recorded. The input value of the asset and depreciation expenses should not be recalculated. According to IAS 16, these reductions are deducted from the initial cost of the asset and the depreciation expense is recalculated from the start date to the present day.

Example

On 01.01.N, SC Mary SA imports a peat-operating plant, the acquisition costs being the following:

- purchase price – 200,000 lei;
- customs duty – 22,000 lei.

The following expenses were made in connection to the asset:

- costs of opening a new installation – 46,000 lei;
- commissioning costs – 36,000 lei;
- testing costs of the correct operation of the asset – 24,000 lei;
- expenses on spare parts (because it was found that the machine did not operate at the initially predicted parameters) – 30,000 lei;
- disassembly costs initially estimated – 78,000 lei.

Duration of use is 10 years and the depreciation is linear.

On 02.02.N, the entity receives a commercial discount of 20,000 lei from the fixed asset provider.

– Cost calculation:

- lei -

• Purchase price	200,000
+ Customs duty	22,000
+ Commissioning costs	36,000
+ Cost of testing the correct operation of the asset	24,000
+ Disassembly costs initially estimated	78,000
Purchase cost	360,000

OMPF No. 1802/2014				IAS 16			
01.01.N							
– The purchase of the machine (the recording is similar for both accounting regulations):							
2131	=	%					360,000 lei
“Technological equipment (machinery, facilities and installations)”		404		“Suppliers of fixed assets”			260,000 lei
		1513		“Provisions for the decommissioning of tangible assets and other related similar actions”			78,000 lei
		446		“Other taxes, taxes and similar payments”			22,000 lei
01.02.N							
– The recording of the depreciation beginning with the month following the commissioning: 360,000 lei/10 years/12 months = 3,000 lei/month				– The recording of the depreciation beginning with the date of the commissioning: 360,000 lei/10 years/12 months = 3,000 lei/month			
6811	=	2813	3,000 lei	6811	=	2813	6,000 lei
“Operating expenses on depreciation of fixed assets”		“Depreciation of installations and means of transport”	(1 month)	“Operating expenses on depreciation of fixed assets, investment property and bearer biological assets evaluated at cost”		“Depreciation of installations and means of transport”	(2 months)
– Receiving the trade discount:				– Receiving the trade discount:			
404	=	4758	20,000 lei	2131	=	404	(20,000 lei)
“Suppliers of fixed assets”		“Other amounts received in the form of investment grants”		“Technological equipment (machinery, facilities and installations)”		“Suppliers of fixed assets”	
				– Canceling the depreciation recorded in addition: 340,000 lei/10 years/12 months = 2,833 lei/month (new depreciation) (3,000 lei – 2,833 lei) x 2 months = 334 lei			
		2813		2131	=	2131	334 lei
		“Depreciation of installations and means of transport”		“Technological equipment (machinery, facilities and installations)”			
01.03.N							
– Recording the monthly depreciation and registering the subsidy received in income:				– Recording the monthly depreciation:			
6811	=	2813	3,000 lei	6811	=	2813	2,833 lei
“Operating expenses on depreciation of fixed assets”		“Depreciation of installations and means of transport”		“Operating expenses on depreciation of fixed assets, investment property and bearer biological assets evaluated at cost”		“Depreciation of installations and means of transport”	

OMPF No. 1802/2014			IAS 16
4758	=	7584	168 lei
“Other amounts received in the form of investment grants”		“Income from subsidies for investments”	(20,000 lei/119 months)

As we can see, the differences between the OMPF No. 1802/2014 and IAS 16 have an impact on the balance sheet and the profit and loss account for that period.

According to IAS 16, the machine will appear on the balance sheet at the value of 340,000 lei. On the other hand, according to the Romanian legislation, it will be presented at the value of 360,000 lei.

In the profit and loss account a depreciation expense reduced with 167 lei/month will be recorded according to IFRSs, but according to the OMPF No. 1802/2014 an income from government subsidies for investments amounting to 168 lei will be accounted for. By summing up all these expenses, at the end of the year we will have significant amounts that will influence on the result of the financial year.

■ Cost of production

The cost of production is the purchase price of raw materials and consumables, including other expenses which may be directly awarded to the good in question.

Expenses included in the production cost	Expenses not included in the production cost
<ul style="list-style-type: none"> the cost, determined in accordance with IAS 2; direct materials assigned to the tangible asset; energy consumed for technological purposes; direct labor; other direct production expenses; share of indirect production expenditure rationally allocated as related to its manufacture; the cost of debt (mandatory capitalized if the period is more than one year). 	<ul style="list-style-type: none"> the value of scrap/waste; overshoots in the consumption of materials and labor; domestic profit.

The records made under the OMPF No. 1802/2014 are similar to those made under IAS 16 and IAS 2, the only deference being the interest expenses, which is not capitalized if the period is not more than one year. The Romanian regulation states that the asset with a long fabrication cycle is the asset whose duration of completion requires a substantial period of time, i.e. more than one year, whereas IAS 23 *Borrowing Costs* only states a substantial period of time.

Example

SC Mary SA builds an administrative building through direct labour operations. The duration of construction according to the documentation is 11 months. The construction is partly financed by a bank loan.

In one month, the entity accounts for the following expenses for the construction of the building:

- expenses on raw materials and materials – 600,000 lei (601 = 301);
- payroll expenses and related contributions – 400,000 lei (641 = 421);
- depreciation of the fixed asset – 24,000 lei (681X = 281X);

- expenses with legal authorizations – 12,000 lei (635 = 446);
- interest on the bank loan – 60,000 lei (666 = 1682);
- bank fees paid for non-utilisation of the credit line according to the credit line chart – 8,000 lei (668 = 462);
- expenses on topographical studies – 100,000 lei (614 = 401);
- expenses with fines before obtaining all approvals – 20,000 lei (6581 = 462);
- design expenses – 60,000 lei (614 = 401).

Total expenses recorded in connection with the fixed asset = 1,284,000 lei

Cost of the fixed asset in progress at the end of the month = 600,000 lei + 400,000 lei + 24,000 lei + 12,000 lei + 60,000 lei + 100,000 lei + 60,000 lei = 1,256,000 lei

OMPF No. 1802/2014				IAS 16			
231	=	722	1,196,000 lei	231	=	722	1,256,000 lei
“Property, plant and equipment in progress”		“Income from the production of property, plant and equipment”		“Property, plant and equipment in progress”		“Income from the production of property, plant and equipment”	
212	=	231	1,196,000 lei	212	=	231	1,256,000 lei
“Buildings”		“Property, plant and equipment in progress”		“Buildings”		“Property, plant and equipment in progress”	
The interest expense related to the bank loan is not included .				The interest expense related to the bank loan is included .			

Once again we notice differences between the two regulations, with consequences on the balance sheet. The value at which the construction will be presented according to IFRSs will increase by 60,000 lei, this amount representing the sum of the interest expenses related to the bank loan.

According to the Law No. 227/2015 on the Fiscal Code, as subsequently amended and supplemented, the legal persons who have own residential buildings have to pay tax on non-domestic property by applying a rate between 0.08% and 0.2% on the taxable value of the building. This is the value from December 31 of the previous year and it can be represented by the fair value, the input value or the reception value of construction works; generally, is the value registered in the balance. This is updated every three years on the basis of an evaluation report drawn up by an ANEVAR member assessor and submitted to the local tax authority.

In our example, the asset of the entity applying IFRSs has a higher value which leads to a higher building tax expense as well as a decrease in the tax result.

■ The fair value

In the initial evaluation of property, plant and equipment, this value is used when registering an asset that is received free of charge or is found to be additional to the inventory.

Example

On 21.08.N, SC Mary SA received a government subsidy for the purchase of an installation in the amount of 20,000 lei, the price of the installation being 120,000 lei.

Case 1: The accounting policy is to recognize the subsidy received as deferred income.

Case 2: The accounting policy is to recognize the subsidy received by deducting it from the carrying amount of the asset.

In both cases, the depreciation of the installation is linear, on a period of 3 years.

Case 1 (IAS 16 and the OMPF No. 1802/2014)				Case 2 (is only valid for IAS 16)			
– Receiving the subsidy:				– Purchase of the machinery:			
4451	=	4751	20,000 lei	2131	=	404	120,000 lei
“Government subsidies”		“Government subsidies for investments”		“Technological equipment (machinery, facilities and installations)”		“Suppliers of fixed assets”	
– Receipt of the subsidy:				– Receiving the subsidy:			
5121	=	4451	20,000 lei	4451	=	2131	20,000 lei
“Bank accounts in lei”		“Government subsidies”		“Government subsidies”		“Technological equipment (machinery, facilities and installations)”	
– Acquisition of the installation:				– Receipt of the subsidy:			
2131	=	404	120,000 lei	5121	=	4451	20,000 lei
“Technological equipment (machinery, facilities and installations)”		“Suppliers of fixed assets”		“Bank accounts in lei”		“Government subsidies”	
– Recording the monthly depreciation: 120,000 lei/3 years/12 months = 3,334 lei/month				– Recording the monthly depreciation: (120,000 lei – 20,000 lei)/3 years/12 months = 2,778 lei/month			
6811	=	2813	3,334 lei	6811	=	2813	2,778 lei
“Operating expenses on depreciation of fixed assets”		“Depreciation of installations and means of transport”		“Operating expenses on depreciation of fixed assets, investment property and bearer biological assets evaluated at cost”		“Depreciation of installations and means of transport”	
– The transfer from advance income to current income: 20,000 lei/3 years/12 months = 556 lei/month							
4751	=	7584	556 lei				
“Government subsidies for investments”		“Income from subsidies for investments”					

The importance of accounting policies can be seen in the example above. Their influence on the financial statements is significant, and therefore the professional accountant or the auditor, before looking at the accounting figures, must read the accounting policies of the company in question and to understand their effect on the accounting result.

The IFRSs allow the deduction of the subsidy received from the carrying amount of the asset, which results in the value of the asset being lower on the balance sheet and having an effect on the profit and loss account due to lower depreciation expenses, calculated at a lower cost. The presentation above highlights the main differences between the two accounting regulations: according to the Romanian legislation, the monthly depreciation expense is 3,334 lei, while, according to the IFRSs, the depreciation expense is 2,778 lei. Depreciation expenses are tax-deductible expenses, so we will also have an impact on deferred corporate tax.

➔ Conclusions

Increasing the credibility of information presented by companies in the financial statements as well as ensuring their comparability with other entities in similar fields leads to attracting new investors and thus, to economic development. Capital market investors want clarity and a common language, which is why the accounting result must be understood by anyone who has an interest and a professional ability to understand. It must reflect the economic reality of the entity, regardless of the country, and respect the accounting principles and rules.

The impact of property, plant and equipment on the balance sheet and the profit and loss account is significant due to the expenses generated – both with depreciation and their maintenance and operation. The chosen accounting policy may influence the amounts recorded in the financial statements, as well as the financial position and performance.

For the proper application of IFRSs, entities are required to approve accounting policies and take all levels of safety in order to comply with the legal provisions. All decisions taken with regard to the accounting of transactions relating to property, plant and equipment must be supported by provisions of the IFRSs.

From the research presented, we deduce the importance of property, plant and equipment and the evaluation methods used. The timing of the evaluation and the forms of the input value of the assets, the content of the main values used, the customizations in terms of the differences between the accounting regulations and the asset valuation are subjects of interest for professional accountants.

The effects of these methods on the financial statements are substantial, so each economic entity is required to provide in the explanatory notes for the financial year details of the applicable general reporting framework, the accounting regulations underlying the preparation of the annual financial statements and the accounting policies used. Any change in accounting policies shall be mentioned in the explanatory notes together with the nature and reasons for the decision taken.

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