

THE REEVALUATION OF TANGIBLE FIXED – ACCOUNTING AND TAX IMPLICATIONS

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Abstract: *The revaluation of the assets represents the economic operation as a result of which the carrying amount of the assets is correlated with their current value, thus ensuring relevant data registration in annual financial statements and, through this, more accurate information of accounting data users. The evaluations made during the reorganization of enterprises (fusions, divisions) don't form a revaluation, these evaluations aiming the determination of the exchange ratio of all the balance sheet elements. Exceptions are the cases where the date of the financial statement that underlies the reorganization is the same date of the annual financial statements. The revaluation of tangible assets is made at their fair value at the date of the balance sheet. The assets' fair value is determined based on evaluations usually made by authorized evaluators, according to the law. The historical costs principle is based on the hypothesis of the stable monetary union, which means that is respecting the nominal values of the currency without taking into account of the purchasing power variations. The practice in the field showed that the application of the fair value in accounting is leading to obtain annual financial statements which provide better information regarding the present and future performances of the economic entity.*

Keywords: fair value, historical cost, accountingvalue, bookvalue, revaluation.

JEL Classification: D

1. Introduction

The revaluation of the assets is the economic operation with the result that the book (accounting) value of the assets is correlated with their current value, thus ensuring the relevant data registration in the annual financial statements and, through this, more accurate information of accounting data users [1].

During the revaluation, the comparison between the fair value and the book value of the particular asset from the balance sheet date is made:

- The fair value is the current value, determined based on evaluations usually made by authorized evaluators qualified in evaluation, members of a professional

organization in this domain. The tangible assets' fair value is usually determined starting with their market value.

- The book value of an asset represents the entrance value (or, where applicable, the gross accounting value as a result of the last revaluation) reduced by the depreciation and the depreciation adjustments for that particular asset.

The accounting in historical costs is a mode of application of the monetary nominalist principle, while the accounting in fair value is a form of market accountings.

2. Brief history of evaluation

The first association of evaluators was established in 1934 in Great Britain. In

1932 and 1935 were established in USA two associations – AIREA and SREA, respectively, dealing with real estate evaluation. In 1991, these two associations merged under the name of Appraisal Institute, which is the global leader of property and real estate evaluators.

In 1992 in Romania the activity of evaluation is set up with the establishment of National Association of Evaluators in Romania (ANEVAR). This takes place in the process of transition to the market economy in Romania, when the market value becomes a basic concept during transactions between parties. The first specialization of the evaluators was the evaluation of enterprise through the programme of privatization of former national and public enterprises. Starting with 1997, a decrease number of enterprises for privatization it is noticed, but the need of enterprises to draw financial resources for the development of the activity created the necessity of these enterprises to sell or to mortgage their extra assets for loans. Thus were created the premises of real estate evaluation, of moving property evaluation and financial instruments evaluation [2].

3. The current value in accounting

The historical costs principle, also called the origin cost principle, means to preserve, at the balance sheet positions, the entrance values which are historical values, adjusted with the booked depreciations and reserves. The historical cost principle is based on the stable monetary union hypothesis, which means that is respecting the nominal values of the currency without taking into account of the purchasing power variations [3].

If the accounting information were reflected at the net worth of output it would mean to determine the difference between the future collections from the selling of an asset, assuming it would be sold, and the supposed expenses with the selling. This value would be given by the net amount received at the selling of an asset.

Therefore, the determination of this value is difficult to get in the case in which the asset is not sold, unlike the historical cost that remain unchanged exactly until the asset is an investee. If we take in consideration the inflation periods, the presentation of the assets and liabilities at the cost level raise various discussions because of the large price variations.

In inflationary periods, the usage of the historical cost has several disadvantages:

- in the balance sheet the fixed assets and the stocks are undervalued, the net situations and equity or own capital are distorted reflected
- in the revenue (profit) and loss account from the annual financial statements are observed the supplies costs and the stock account at a lower level than usual, undervalued, undervaluation of the depreciation costs as a result of undervaluation of assets, overestimation of financial costs based on the earnings or profit over liabilities or debts (for example: supposing the interest rate is 14%, the inflation rate 6%, the real interest-rate in the case of a non award loan is $14\% - 6\% = 8\%$), overestimation of the results and, then, the increasing of the corporate income taxes, undervaluation of the inputs costs or expenses etc.

The practice in the field showed that the application of the fair value in accounting is leading to obtain annual financial statements which provide better information regarding the present and future performances of the economic entity. The accounting value or the book value is the value at which an asset is recorded in the balance sheet, after the deduction of the depreciation and of the value losses registered as reserves, and the recoverable value is the highest value between the fair value, decreased with the selling expenses, and the utility value. The fair value is the value that would be obtained from the sale of the asset, in a transaction, under competitive market conditions, between

committed shareholders, well informed and in agreement with the transaction.

Case study:

Assuming an economic entity is acquiring an industrial installation in the following terms: purchase price of 24.000 lei from the assets supplier, transport costs according to the invoice of 8.000 lei. By contract agreement, the firm is obliged to remove the installation and restore the vegetation at

the end of the operating period. The contractual period is 4 years. The estimated costs to decommission the installation and to restore the vegetation are 10.000 lei. The discount rate (update rate) is 10%.

Solution:

- The reception of the installation at the value invoiced by the supplier, including the transport and installation (24.000+8.000 = 32.000 lei)

2131 "Technological equipment (machinery, equipment, facilities)	=	404 "Assets providers"	32.000
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- The acknowledgement of the estimated cost regarding the engagement to remove the installation and to restore the vegetation.

We will use the updating – a technique used for the determination of the output or efficiency values.

According to the evaluation standards, the updating calculations take into consideration the expected growth and the placing in time of the results, of the risk related to the flow of results and to the value of money in time.

A result or a value to which the updating technique is applied becomes a current or present value.

The concept of current or present value is based on the value of the money in time. A "leu" received today values more than a "leu" received in a year or at another future time, mainly because it cannot be used in other purposes (for example for obtaining an interest from financial investments). The determination of the present value consists in the equivalence at present time of certain values made in the future.

The transformation technique of a value or amount which will receive in the future current values is known as updating. The updating is the reverse technique of capitalization or revenues formation. The capitalization allows the determination of a future value of an amount placed at a certain fruition rate (interest rate). The

updating allows knowing how much values an amount today, S_n , which would be obtained over n years, taking into account that, if it would dispose that amount today, this could be capitalized on certain profitability (return) d .

To conclude, updating a future amount means applying to it an updating factor like $1 / (1 + d)^n$.

The fruition rate or profitability rate of the assets such as interest, included in the updating factor, penalizes the amounts that would be obtained in the future because, regardless of inflation, these value less today due to the risks that could appear in the future, along with the loss of the opportunity to invest the same amount today, on another market, at the intended profitability, d [4].

The interest, used as a profitability rate of capitals, represents the cost of using the money on a specific time period, in the same way the rent represents the cost of using a tangible asset in a specific time period.

In practice the tables and spreadsheets for financial mathematic calculation are used, calculation based on a certain interest rate in a specific period of time.

The current value for a "leu" will be determined by the formula:

$$a = \frac{1}{(1 + d)^n} \quad (1)$$

Where:

a – the current value of an invested leu;

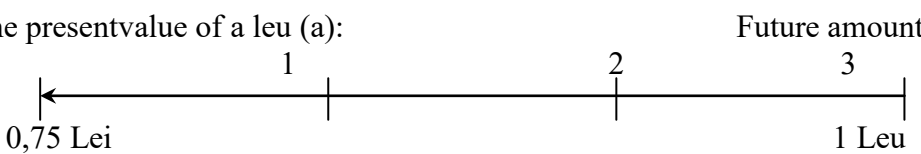
d – the annual interest rate;

n – the number of years of considered period of time.

This formula is used when intending the updating of a **unique amount**, which will

Example:

The present value of a leu (a):

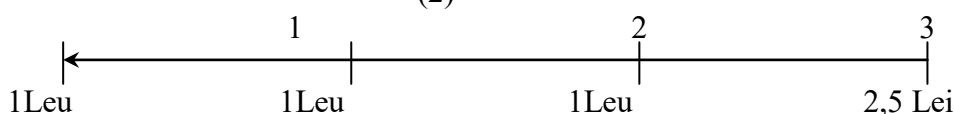


$$a = \frac{1}{(1+d)^n} = \frac{1}{(1+0.1)^3} = \frac{1}{1.331} = \mathbf{0,75}, \text{ so 1 leu invested in 3 years, values now 0,75 lei.}$$

If the updating of an annuity is intended, which represent a fixed annual amount which would be received in certain number of years; it will proceed to the reduction of each equal periodic amount, applying the formula [5]:

$$A = \frac{1 - \frac{1}{(1+d)^n}}{d}$$

(2)



$$A = \frac{1 - \frac{1}{(1+d)^n}}{d} = \frac{1 - \frac{1}{(1+0.10)^3}}{0.10} = \frac{1 - 0.75}{0.10} = \frac{0.25}{0.10} = \mathbf{2,5 \text{ lei}}$$

In our case:

$$\mathbf{10.000 * (1 + d)^4 = 10.000 * (1+0.1)^4 = 14.641 \text{ lei}}$$

2131 "Technological equipment (machinery, equipment, facilities)	=	1513 "Reserves for decommission of tangible fixed assets and other similar related actions"	14.641
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So, the initial cost of the installations: 32.000 + 14.641 = 46.641 lei

4. The revaluation of tangible fixed assets – accounting and fiscal implications

According to Decree no.1802/29.12.2014 for the approval of the Accounting Regulations regarding the consolidated

be received at a specific future date, and is shown schematically like this:

n= the number of years of the specific time period is 3 years;

d= the annual interest rate 10%

Where:

A - the current value of an annuity.

Example: The Updating of an annuity is shown schematically like this:

n = number of years of the specific time period is 3 years;

d = annual interest rate 10%.

The current value of „n” rents of 1 leu:

Forecasting timescale:

annual financial statements (MO 963/30.12.2014), with the successive modifications, adjustments and additions, the depreciation calculated for intangible assets thus reevaluated are registered in the

accounts starting with the following financial or accounting period from which the reevaluation was made.

If a tangible asset completely amortized can still be used, the entity can proceed to the reevaluation. On the occasion of reevaluation of the intangible asset, a new value and a new duration of economic utilization is set for the asset, relevant for the next estimate period of usage or utilization.

The evaluations made in the case of reorganization of the enterprise (fusions, divisions) don't form revaluation under the accounting regulation presented listed in the Decree 1802/2014 for the approval of Accounting Regulations regarding the consolidated annual financial statements, these evaluations being made in order to determine the exchange ratio, for all the balance sheet elements. Exceptions are the cases where the date of the financial statements underlying the reorganization is the same with the date of annual financial statements.

The revaluations of tangible fixed assets are made at the fair value from the date of the balance sheet. The fair value is set based on certain evaluations usually made by authorized evaluators, according to the law. At the revaluation of a tangible asset, the cumulative depreciation or amortization on the date of revaluation is addressed in one of these ways:

a) recalculated proportionally to the change of the gross accounting value of the asset, in such a way as the accounting value of the asset, after revaluation, to be equal to its revaluated value. This method is often used in the case when the asset is revaluated by applying an index (the gross value method); or

b) removed from the gross accounting value of the asset, determined as a result of the correction with the value adjustments, is recalculated at the revaluated value of the asset (the net value method). This method is often used for the buildings which are revaluated at their market value.

If, after the initial recognition as asset, the value of a non-current asset is determined based on the revaluation of that particular asset, the resulted value from the revaluation will be allocated to that asset. In such cases, the regulation concerning the depreciation will be applied to the asset considering its value, determined as a result of revaluation.

The elements from a category of tangible fixed assets are revaluated simultaneously to avoid the selective revaluation and the reporting in annual financial statements of some values which are a combination of costs and calculated values at different dates.

If a non-current asset is revaluated, all other assets from the category to which it belongs must be revaluated.

A non-current assets category includes same type and similar uses assets, which are in the exploitation of an entity.

Examples of categories of non-current assets are: land and real estate property, buildings; machinery and equipment; ships; aircrafts, planes etc.

The revaluation must be done regularly enough, so that the accounting value doesn't significantly vary from the value that would be determined using the fair value from the balance sheet date.

If the revaluation of the non-current assets is made, the difference between the value resulted from the evaluation based on the acquisition cost or production cost and the value resulted based on revaluation must be presented in the balance sheet at the supply (reserves) of revaluation.

The excess from the evaluation included in the supply of revaluation is capitalized through direct transfer to the retained earnings, when this excess represents a realized income.

In terms of these regulations, the profit is considered realized at the withdrawal from the record of the asset for which the supply of revaluation was made up. However, a part of the income can be realized as the asset is used by the entity. In this case, the

value of the transferred supply is the difference between the depreciation calculated based on the revaluated accounting value and the depreciation value calculated based on the initial cost of the asset.

If the result of the revaluation is an increment over the accounting net value, than it is addressed like this:

- like an increase of the supply of revaluation, if there haven't been a previously decrease identified as a related expense of that asset; or
- as an income to compensate the expense with the prior identified decrease of that asset.

If the revaluation result is a decrease of the accounting net value, it shall be treated as an expense with the whole value of devaluation, when in the supply of revaluation is nor registered an amount regarding that asset (excess of revaluation) or as a subtraction of the revaluation supply shown within the "Capital and reserves" element, with the minimum between the value of that reserve and the decreasing value, and the possible uncovered remained gap or difference is registered as an expense.

The amounts representing the differences such as revenue and expenses obtained from revaluation must be separately presented in the profit and loss (income statement) (the account 755 "Revenues from revaluation of the tangible assets", the account 655 "Expenses from the revaluation of the tangible asset" respectively, as required).

No part of the supply of revaluation can be distributed, directly nor indirectly, except

the case does it represent effective revenue realized.

In the case of lands, real estate and buildings that were revaluated and were subject of a partial disposal, at their removal from the register, the difference from the revaluation related with the disposal part is considered excess realized from the revaluation supplies, corresponding to the accounting value of the lands, and buildings respectively, removed from the register, and the retained result is highlighted representing the excess made from the revaluation supplies.

From a fiscally point of view, the firm will consider taxable income the amounts transferred in the retained earnings representing the excess realized from the revaluation supplies or reserves, at the calculation of corporate income tax.

The value adjustments are calculated in each financial period based on the revaluated value of those fixed assets.

Case study:

SC Euro Invest SRL owns a land with no constructions registered in accounting at an acquisition cost of 100.000 lei. At the end of the financial year 2015, the land was revaluated, according to the report of evaluation, at a fair value of 165.000 lei. At the end of 2017, the land is revaluated again at the fair value of 185.000 lei. On 23.04.2018 the land is sold at the selling price of 140.000 lei, VAT 19%. Where applicable, the possible existing revaluation supply in the balance at the selling date is transferred at the retained earnings representing the excess realized from the revaluation supply (cont 1175). What if on 31.12.2017 the revaluated value would be: b) 130.000 lei; c) 90.000?

Solution:

a) Revaluation of the land on 31.12.2015: $165.000 - 100.000 = 65.000$

2111 "Lands/Real Estate"	=	105 "Revaluation supplies(reserves)"	65.000
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- Revaluation of the land on 31.12.2017: $185.000 - 165.000 = 20.000$

2111 "Lands/Real Estate"	=	105 "Revaluation supplies"	20.000
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- Selling of the land on 23.04.18:			
461 "Debtors"	=	%	<u>166.600</u>
		7583 "Revenue from the selling of assets and other operations on capital"	140.000
		4427 "Collected VAT"	26.600
- The discharge statement of the land on 23.04.2018:			
6583 "Expenses regarding the disposal of assets and other operations on capital"	=	2111 "Lands/Real Estate"	185.000
- The transfer of the supply of revaluation to the retained earnings representing the excess realized from the supply of revaluation and which would be taxed at the selling on 23.04.2018:			
105 "Supplies (reserves) from revaluation"	=	1175 "The retained earnings representing the excess realized from the supplies from revaluation"	85.000
b) Revaluation of the land on 31.12.2015: $165.000 - 100.000 = 65.000$			
2111 "Lands/Real Estate"	=	105 "Supplies (reserves) from revaluation"	65.000
- Revaluation of the land on 31.12.2017 (we notice a decrease, which means a lowering (reduction) of the accounting net value of the land: $130.000 - 165.000 = - 35.000$)			
105 "Supplies (reserves) from revaluation"	=	2111 "Lands/Real Estate"	35.000
- Selling the land on 23.04.18:			
461 "Debtors"	=	%	<u>166.600</u>
		7583 "Revenue from the selling of assets and other operations on capital"	140.000
		4427 "Collected VAT"	26.600
- The discharge statement of the land on 23.04.2018:			
6583 "Expenses regarding the disposal of assets and other operations on capital"	=	2111 "Lands/Real Estate"	130.000
- The transfer of the supply of revaluation to the retained earnings representing the excess realized from the supply of revaluation and which would be taxed at the selling on 23.04.2018			
105 "Supplies (reserves) from revaluation"	=	1175 "The retained earnings representing the excess realized from the supplies from revaluation"	30.000

c) Reevaluation of the land on 31.12.2015: $165.000 - 100.000 = 65.000$

2111 "Lands/Real Estate"	=	105 "Supplies (reserves) from revaluation"	65.000
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- Revaluation of the land on 31.12.2017: $90.000 - 165.000 = - 75.000$

%	=	2111 "Terrains"	75.000
105 "Supplies (reserves) from revaluation"			65.000
655 "Expenses from the revaluation of the tangible asset"			10.000

- Selling the land on 23.04.18:

461 "Debtors"	=	%	166.600
		7583 "Revenue from the selling of assets and other operations on capital"	140.000
		4427 "Collected VAT"	26.600

- The discharge statement of the land on 23.04.2018:

6583 "Expenses regarding the disposal of assets and other operations on capital"	=	2111 "Lands/Real Estate"	90.000
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5. Conclusions

The revaluation must be made regularly enough, so that the accounting value doesn't substantially differ from the one determined using the fair value from the balance sheet date.

Regarding the tax on buildings, for the buildings which are not revaluated,

increased tax return rates are set. Therefore, the tax return rate on buildings is set through a decision of the local council, since there are very big differences between the rates of the tax for the tangible fixed assets revaluated and those who aren't revaluated.

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