

## **RECOGNITION OF IMPAIRMENT LOSSES OF INTANGIBLE ASSETS IN ROMANIA VERSUS IFRS**

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### **—Abstract —**

Developments in accounting, which harmonize with the European Directives and International Financial Reporting Standards, are correlated with progress in the field from Europe and worldwide, leading to a change of view in the accounts.

International Accounting Standard IAS 36 "Impairment of Assets" recommended that the recoverable amount of an asset is assessed every time an indication of impairment appears, while in Romania the accounting rules require that the evaluation of intangible assets is to be achieved at the end of the year when according to the legislation, the inventory takes place. Although current legislation took nearly all the recommendations of the International Accounting Standards, in practice there are difficulties regarding the recognition of impairment losses.

**Key Words:** *fair value, assessment, reassessment, recognition, balance sheets.*

**JEL Classification:** M41 Accounting, M21 Business Economics

## 1. INTRODUCTION

Developments in accounting, which harmonize with the European Directives and International Financial Reporting Standards, are correlated with progress in the field from Europe and worldwide, leading to a change of view in the accounts.

According to the definition of assets, they are a resource entity, which is expected to generate future economic benefits for itself. Currently, these future benefits can be significantly different, much lower for many companies, from those estimated in the previous period (of economic prosperity).

Moreover in the current situation, taking into account the requirements of International Accounting Standards, all companies should evaluate whether the intangible or tangible assets made before the global crisis are any longer valid.

Although the Romanian accounting regulations are not as clear and do not include detailed recommendations on the calculation of recoverable amount, compared with International Accounting Standards, the general requirements are the same - the carrying amount may not differ significantly from the fair value according to the Law of Accounting in Romania.

To obey the principle of prudence and true and fair image, companies should recognize impairment losses in the financial statements. Will they do this, given that this information will be made public?

## 2. PARAMETERS OF IMPAIRMENT

According to IAS - International Accounting Standard 36 "Impairment of Assets" (IFRS, 2011) an impairment loss is the amount by which the carrying amount of an individual asset (or cash-generating unit) exceeds its recoverable amount.

In other words, an asset is impaired when:

- the recoverable amount of the asset is greater than the amount it is listed in accounting and there is no depreciation;
- the recoverable amount of the asset is less than the carrying amount of the asset which is depreciated

The cash-generating unit (Treasury) (IFRS, 2011) is the smallest identifiable group of assets that generates cash inflows from ongoing use, entries that are largely independent cash inflows from other assets or groups of assets.

International Accounting Standard IAS 36 "Impairment of Assets" states that the recoverable amount of an individual asset cannot be determined if:

- the usefulness of the asset cannot be estimated as closed to the fair value minus costs of selling (for example, if the future cash flows resulting from the ongoing use of the asset are not negligible)
- the asset does not generate cash inflows that are largely independent from those generated by other assets.

In such cases, the usefulness and also recoverable amount can be calculated only for the cash generating unit.

The accounting regulations in Romania use the term interim adjustment for impairment or loss of value, which is defined as follows:

**Value adjustments** comprise all adjustments intended to take account of reductions in individual asset values established at the balance sheet date whether that reduction is final or not.

Evaluation of intangible assets on the balance sheet is the value of inventory, that means the current value determined according to the heritage inventory and according to this it is determined whether the asset was impaired or not.

When:

- the inventory value is larger than the amount that is listed in the books, in the inventory lists are written the accounting values, so there is no impairment;
- the inventory value of the asset is less than the book value, in the inventory list it is written value of inventory, so there is no impairment of the asset.
- correction of the value of intangible assets and bringing them to the value of inventory is performed, depending on the type of impairment, either by recording an additional impairment, if there is a irreversible impairment, or by adding adjustments.
- starting from the two definitions of depreciation provided by the International Accounting Standard IAS 36 "Impairment of Assets" and the Romanian accounting standards we found the following:
  - The International Accounting Standard uses the term recoverable value and clearly defines this term as the higher of an asset's fair value less costs to sell and its value in use.
  - The Romanian accounting standards use the term asset value, which is not clearly defined, stating only that it is determined by the usefulness of the property, its condition and the market price.

➤ A company should assess at the end of each reporting period, if there is any indication of impairment of its intangible assets. When there is such evidence the company must estimate the recoverable amount of the asset. However, it is not a requirement that the possible impairment be calculated for all assets at the end of each financial year, because it would be a very laborious task for many companies. The decision to calculate depreciation of assets is based on certain external and internal information.

According to the International Accounting Standard, IAS 36 “Impairment of Assets”

External sources of information:

- during the period it was a market value decline, more than it was expected;
- during the period there were significant negative changes in technology, markets, economy or legislation;
- the net book value of the assets is higher than the market interest rates;
- there is evidence of obsolescence or physical damage of an asset;

Internal sources of information:

- during the period significant changes occurred that affected negatively the entity, and such changes will occur in the near future regarding the extent or manner in which the asset is used or expected to be used. Such changes include situations where an asset is unproductive, restructuring plans or business interruption, asset disposal earlier than expected, and reassessment of the life of an asset as determined and undetermined ;
- internal reports make available evidence that the economic results of an asset are or will be worse than expected.

In general as frequency for impairment tests the International Accounting Standard IAS 36 "Impairment of Assets" states that the recoverable amount of an asset must be evaluated every time a sign of impairment appears.

If there is an indication of the possible impairment of an asset, this may indicate that the remaining period of life, depreciation method and residual value of the asset should be reviewed and adjusted, even if they do not recognize any impairment loss for that asset.

Accounting regulations in Romania harmonized with the European directives take most of the information from International Accounting Standard IAS 36

"Impairment of Assets" on the internal and external sources that should influence the decision making for the calculation of asset impairment.

Evaluation of intangible assets in Romania is made at the closing of the financial year when, according to the law, there is the general inventory.

Evaluation of assets is done according to the principle of the permanence of methods, which means that models and evaluation rules should be maintained to ensure coherence and comparison over time of the accounting information.

While the International Accounting Standard IAS 36 "Impairment of Assets" recommended that the recoverable amount of an asset is assessed each time an indication of impairment appears, in the Romanian accounting rules we found that the evaluation of intangible assets is made at the closing of the financial year when, according to the law, there is a general inventory, whether occurring or not an indication of impairment of assets.

If International Accounting Standard IAS 36 "Impairment of Assets" recommends that when there is evidence of impairment the remaining period of life for the item should be reviewed and adjusted (IFRS, 2011), the amortization method or the residual value of assets adjusted even if it is not recognized any impairment loss on that asset, accounting rules prohibit this practice in Romania adding that the evaluation of assets is done according to the principle of permanence of methods, justifying this by ensuring the coherence and comparison of accounting information over time.

According to International Accounting Standard IAS 36 "Impairment of Assets", if an asset's recoverable amount is less than its carrying amount, the carrying amount of the asset should be reduced to be equal to the amount recoverable. Such a reduction is an impairment loss. The standard takes into account several criteria to recognize the impairment loss: permanence, probability and economic criteria.

a) permanence criterion

Recognition of a loss takes place only if it is considered that the impairment loss is permanent. Those who agree with this criterion consider that it avoids recognition of temporary reductions of the recoverable amount of an asset and that is contrary to the historical cost system to account for future events, taking into consideration the fact that recognizing an impairment loss relates to future activities. Also, the impairment will reflect these future losses over the entire remaining life of the asset.

IASB has decided to reject the criterion of permanence, because it is difficult to determine whether an impairment loss is permanent. There is a risk that by enforcing this criterion recognition of an impairment loss should be delayed.

This opposes to the basic concept according to which an asset is a resource generating future benefits. Accrual accounting based on costs can not reflect events without reference to future expectations. If the events that led to a reduction in the recoverable amount had already occurred, the carrying amount should be reduced accordingly.

b) probability criterion

Recognition is based on the assumption that depreciation of the asset is probable, which means that the company is likely not to recover the asset's carrying.

Such a criterion can be used in two ways:

- Use a tool for recognition based on the value of future cash flows undiscounted and without interest cost allocation.
- Recognition as contingent events occurring after the balance sheet date, respectively, as a liability and expense, if:
  - It is likely that future events may confirm that, although recoveries were taken into account, an asset was impaired or a liability occurred at the balance sheet date
  - The value of the resulting loss can be reasonably estimated.

IASC rejected such an option, because:

- The requirements of International Accounting Standard IAS 10 "Events after the reporting period" were not sufficiently detailed and would make difficult to apply the probability criterion.
- The requirements would have introduced another layer of unnecessary probability. It is true that probability factors have already entered in estimates of value in use and the requirement that the recoverable amount be the higher than the fair value less costs to sell and value in use.

c) economic criterion

Accounting recognition is immediate whenever recoverable amount is less than the book value. International Accounting Standard IAS 36 "Impairment of Assets" is based on an economic criterion for recognition of an impairment loss: an impairment loss is recognized whenever the recoverable amount of an asset is lower than its accounting value.

This criterion has been already used in several International Accounting Standards before IAS 36 before, such as IAS 9 *Research and development costs*, IAS 22 *Business Combinations* and IAS 16 *Property, Plant and Equipment*

IASC considered that an economic criterion is the best criterion for users to provide useful information to assess future cash flows that will be generated by the enterprise as a whole. In estimating the time value of money and specific risks of an asset, when you have to determine whether an asset is impaired, there are taken into account factors such as probability or permanent loss from impairment.

### **3. RESUMPTION OF A LOSS FROM IMPAIRMENT OF INTANGIBLE**

Impairment loss accumulated in the balance over past years can be canceled as a whole or in part, when there is a change in estimates that first led to its recognition.

The process of resumption of a previously recognized impairment is the reverse process of its recognition. At the end of each reporting period a company has to assess whether there is evidence that the reduction or cancellation of an impairment loss prior recognized for an asset. If there is a hint related to this process, the company must estimate the recoverable amount of that asset. Resumption of the impairment loss for an asset should be recognized immediately in profit or loss for the period, unless the asset is carried at revalued amount.

Any reversal of impairment loss of a revalued asset should be treated as a re-evaluation increase. After recognition of an impairment loss, depreciation expense related to that asset should be adjusted later in order to allocate, on a systematic basis during the remaining period of usefulness of the asset, the revised carrying amount of the asset less its residual value (if any). A resumption of an impairment loss reflects an increase of the estimated potential of an asset either through use or by sale from the date an entity last recognized an impairment loss for that asset. International Accounting Standard IAS 36 "Impairment of Assets" also requires the recognition of changes that occur in the estimates and which generate a growth in the potential of services. Examples of changes in estimates include:

- a change in the data base for determining the recoverable amount (ie the recoverable amount is based on the fair value less the costs to sell or value in use);
- a change in the amount or timing of estimated future cash flows or the discount rate, if the recoverable amount was based on value in use; or
- a change of estimated components of the fair value less the selling costs, if the recoverable amount was based on fair value less the selling costs.

The usefulness of an asset can become bigger than the carrying amount of an asset simply because the present value of future cash inflows increases when approaching future cash inflows over time. However, the service potential of the asset has not increased.

Thus, an impairment loss is not reversed over time, even if the asset's recoverable amount is higher than its book value.

The company does not have to recalculate and to resume annual or periodic impairment loss, only when there are reasons which indicate that the factor that led to the recognition of depreciation is missing or has not diminished its effect.

In time, the recoverable amount increases not due to a change in estimates used to calculate the recoverable amount of the asset, but as a result of the methodology for calculating the discount rate. These increases do not have to be recognized by the company. The standard does not allow a company to recognize a recurrence of an impairment loss only because it has been an update or for practical reasons. Thus, if an impairment loss is recognized and the recoverable amount is based on the value in use, a recurrence of the impairment loss shall be recognized in each of the following years for running an update as an asset impairment structure is different from the structure of the value in use.

Due to the accounting regulations in Romania the decisions regarding resumption of depreciation recorded in accounts adjustments are based on the inventory commission findings. There may be some indications that an impairment loss recognized in prior periods for an intangible asset no longer exists or has decreased. This evaluation takes into account internal and external sources of information presented above.

In the Romanian accounting, resumption of a loss of value of an intangible asset should be immediately accounted to income in the profit or loss account.

International Accounting Standard IAS 36 "Impairment of Assets" does not allow an enterprise to recognize a resumption of an impairment loss only because of running the update, while the Romanian accounting standards do not specify anything with this regard.

In accordance with International Accounting Standard IAS 36 "Impairment of Assets", the company takes the depreciation only if the reasons which led to the recognition of depreciation have disappeared or have been removed or improved by performance of the asset, while in Romania decisions on resumption of depreciation recorded in accounts adjustments are based, primarily on the inventory commission findings. Another difference between the Romanian

accounting system and the International Accounting Standard IAS 36 'Impairment of Assets' is related to the revaluation of reserve considering the depreciation. The standard recommends that any reversal of impairment loss of a revalued asset should be treated as a revaluation increase, while the Romanian accounting rules state that the revaluation reserve cannot be affected by adjustments (losses or assessments) of value, as they are recorded directly into expense accounts.

Example:

At the end of 2008, the company M bought company X at a cost of 9,000 EUR, out of which the fair value of identifiable assets 6.000 EUR and goodwill 3,000 EUR.

Suppose that the recoverable amount is determined by the utility value.

At the end of 2008 and 2009, the utility value is higher than book value.

In the year 2010, the country in which X is, has imposed some export restrictions on products manufactured by X it is expected a dramatic decrease in production.

At 31.12.2008 estimates related to depreciation are: the left period of 12 years, linear method, zero residual value.

At 31.12.2010, the recoverable amount of cash-generating unit is 4080 EUR.

In 2011, the situation in the country in which X is starts to improve and it is expected an increase in production. At 31.12.2011, the recoverable amount of cash unit X is 5730 EUR.

**Situation at 31.12.2010:**

Elemente	Goodwill	Identifiable assets	Total
Input value	3.000	6.000	9.000
(-)Accumulated impairment(*)	-	1.000	1.000
= Net book value at 31.12.2010	3.000	5.000	8.000
Recoverable value			4.080
Constant impairment (8.000 – 4.080)	3.000	920	3.920
Net book value after impairment	0	4.080	4.080

(\*)Identifiable asset depreciation at 31.12.2010 = 2 years x 6.000/12 = 1.000 EUR

”Impairment of property expenses” = % 1.920 EUR  
 ”Goodwill impairment” 3.000  
 ”Impairment for  
 identifiable assets” 920

Since the cash-generating unit X has been allocated goodwill, it must be tested annually. It has been noticed, though, that at the end of 2008 and 2009, the utility is greater than its recoverable amount, so there is no impairment.

**Situation at 31.12.2011:**

Elements	Goodwill	Identifiable assets	Total
Net book value at 31.12.2010	0	4.080	4.080
(-)Exercise impairment 2011(*) = Net book value at 31.12.2011	-	408	408
	0	3.672	3.672
Recoverable value			5.730
Reversible potential impairment (5.730 – 3.672)			2.058
Net carrying amount that identifiable assets would have had if previously not impaired 6.000 – 3*6.000/12			4.500
Impairment that can be resumed to identifiable assets (4.500 – 3.672)		828	828

(\*)Exercise impairment 2011 = 4.080/10 = 408 EUR

”Impairment of identifiable assets” = ”Income from 828 EUR  
 provisions for  
 impairment of assets”

**4. CONCLUSIONS**

While the International Accounting Standard IAS 36 "Impairment of Assets" recommends that the recoverable amount of an asset should be assessed every time an indication of impairment appears, in the Romanian accounting rules the evaluation of intangible assets is made at the closing of the financial year when, according to the law, there is the general inventory, whether or not it occurs an indication of impairment of assets. Accounting regulations in Romania harmonized with the European directives take most of the information from International Accounting Standard IAS 36 "Impairment of Assets" regarding the internal and external sources that influence the decision making for the calculation of asset impairment.

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