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The Evaluation Subsequent to the Recognition of Fixed Tangible Assets for Public Institutions – Method Based on Cost

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Abstract

As far as the public domain is concerned, the necessity for decreasing the differences between national and international accounting standards generated the need for an accounting harmonization. The purpose of this harmonization is to achieve the comparability of information from public institutions, in other words, to decrease the differences between countries regarding the evaluation and recordings in accounting, regarding the evaluation of patrimony, of the achievements and financial position. The preference for a specific accounting policy is determined by the need to illustrate an accurate financial situation and performance. Therefore, it is necessary to select an optimal accounting policy for the evaluation of fixed tangible assets as well, a policy that provides the relevant, prudent and complete information under all significant aspects through the means of financial situations.

Keywords: Future Evaluation, Fixed Tangible Assets, Tangible Assets, Depreciation, Adjustment For Temporary Depreciation, Cost Model

Introduction

The accounting of public institutions is characterised as being an open and apprehensive domain regarding political, economic, social and cultural changes. As a result, the present informational requirements imposed the use of a common language as far as the financial reporting is concerned. The evolution targets, as far as possible, the improvement and reduction of the differences between the national legislation and regulations. It also targets the elaboration of legislation and principles which should conduct to the comparability of information provided by the financial situations of the entities in the public domain, trying to reduce at the same time the differences between accounting policies from different countries.

This paper is aimed to illustrate an analysis of the convergence and harmonization grade of the national accounting legislation regarding the recognition and accounting for transactions related to fixed tangible assets with the international accounting standard for public domain IPSAS 17 'Tangible assets', by identifying the similarities and differences of the two standards. Furthermore, this paper also presents the main accounting transactions

regarding fixed tangible assets, by dividing them into assets that can be depreciated and assets that cannot.

The nature and the mechanisms of the accounting harmonization in every country are based on the culture, traditions and the economic environment, these items being the elements that influence the theorization in accounting. The necessity of having a general accounting system based on accounting standards led in 1977 to the founding of IFAC – International Federation of Accountants. In present times, it is the global organisation for the accounting profession in the public sector. Its objective is to serve the public interest, to strengthen the accounting profession worldwide through the initiation and promoting of adherence at high-quality professional standards, as well as the debating of public interest problems where the professional experience is extremely relevant.

In order to achieve these goals, the Committee of IFAC founded the Committee for International Accounting Standards in the Public Sector (IPSASB). Its role is to elaborate high-quality standards in order for entities in the public domain worldwide to use them when preparing the financial situations:

In Romania, the accounting policies for organising the accounting of public institutions are elaborated in accordance with the International Standards for Public Sector (IPSAS), elaborated by the IPSASB. As a consequence, the organising of accounting for public entities is realised in conformity with the provisions of the Order of the Minister of Public Finance number 1917/2005 and the Accounting Law number 82/1991, republished and with all subsequent changes and improvements made. The legislation states that all public institutions must keep a double entry accounting, an accounting policy based on the accrual principles.

The terminology used in this paper refers to ‘fixed tangible assets’, as the national legislation presents it, or ‘tangible assets’, as the international standards for public domain disclose it. The international legislation which refers strictly to tangible assets is IPSAS 17 “Tangible Assets”. The depreciation is presented in another regulation, named IPSAS 21 – “the depreciation of assets which generate monetary flows”.

The Evaluation of Tangible Assets/fixed Tangible Assets, Subsequent to the Recognition of Them

Conceptual Dimension

An entity, in order to evaluate its fixed tangible assets/tangible assets after their recognition, has to select an accounting policy which will be applied to the entire class of tangible assets. The selection is made between two policies: the basic accounting treatment (the model which is based on cost) or the alternative accounting treatment (the model which is based on revaluation). There isn't a perfect match between all national accounting regulations and the International Accounting

Standards for the public domain, due to the following arguments:

a. The national regulations only stipulate the basic accounting treatment (the model which is based on cost). Therefore, a fixed tangible asset must be valued afterwards (in the statement of financial position) taking into account the initial value and the accumulated adjustments for its value. These adjustments comprise all the corrections that should be made in order to consider the decrease in value of individual assets, regardless of the fact that whether the reduction is permanent (depreciation) or not (adjustment for depreciation).

b. The International Standard IPSAS 17 “Tangible assets” states the possibility of choosing between one of the two methods: the basic accounting treatment (the model which

is based on cost) or the alternative accounting treatment (the model which is based on revaluation).

Similarities and differences in the case of the subsequent recognition, using the method based on cost

In the case that an institution decides to use this method, the fixed tangible asset/tangible asset has to be recognised at a value which is equal to its cost, minus any accumulated depreciation and any losses accumulated due to the depreciation.

In order to determine whether an asset is or is not depreciated, an entity has to apply the IPSAS 21 “the depreciation of assets which generate monetary flows”. According to this standard, the depreciation is defined as a loss of future economic benefits or future services that an asset might have generated loss which is bigger than the systematic recognition of losing future economic benefits or services generated by an asset through depreciation (amortization).

The depreciation refers to a systematic allocation of the depreciable value of an asset over the period of its useful life. As far as the beginning/ ending of depreciation is concerned, the following provisions exist :

1. Regarding IPSAS 17 “Tangible assets”, the depreciation of an asset begins when this asset is available to be used, in other words, when it is placed at the proper location and its state is appropriate to be operated in the conditions expected and stated by the board.

The depreciation of an asset ends when the asset is un-recognised. As a consequence, the depreciation does not end when an asset is no longer operated or retired from its useful life and only held in order to be disposed. There is one exception, because as far as the methods of the use of depreciation are concerned, the depreciation expenses can be null as far as no production exists.

2. According to O.M.F.P. no.1917/2005, the depreciation is registered monthly, starting the month subsequent to the month when the asset was received or put into operation, until the full retrieving of the input value, according to its operation rules. The moment of the putting into operation in order to determine the value of depreciation is as follows [O.M.F.P. no.3.471/2008, article15]:

–The independent fixed tangible assets, that do not require fitting or other technical testing are considered to be put into operation at the date of their acquisition, based on the minutes of reception;

–The equipment that require fitting, but no technical testing, and also the buildings and special constructions that do not serve technological processes are considered to be put into function at the date when the fitting ends or at the date when the building is finished, based on the minutes of reception;

–The equipment and installation that require fitting and special technical testing, as well as buildings and special constructions that serve technological processes are considered to be put into operation when the testing ends, based on the minutes of reception.

Characteristics/principles regarding the depreciation of some fixed tangible assets in the case of public institutions in Romania [O.M.F.P. no.3.471/2008, Article 16 – 25]:

a. Those elements which are partly operative and for which the registration forms are not yet prepared will be registered as fixed tangible assets at the value of total expenses incurred due to their execution. When the forms will be ready and they will be fully put into operation, the depreciation is determined according to the final value, and the unamortized value up to that date will be recovered in the normal period left for operation.

b. The investments made for the improvement of lakes, pools, ponds, lands and other similar works are retrieved on the basis on amortisation, by including the expenses of the public institution throughout a period of maximum 10 years, as long as the approval of the officer exists.

c. Young and protection plantations are exempted from the calculation of depreciation until either the changing of nature of the land (for young plantations, when these will be used for harvest) or after the first five years (in the case of protection plantations). The normal period of operation for these two elements normally include the exemption period; thus, the depreciation rate is determined based on the difference between the normal period of use and the exemption period, in years.

d. The depreciation of fixed tangible assets which are rented to third parties, held in consignment or used freely is determined by those public institutions that have them in their patrimony.

e. The depreciation of investments made for the rented fixed tangible assets by the public institutions is registered by the public institutions or the economic agents who made those investments, during the period of the contract or the remaining normal period of functioning, if the case. At the ending of the contract, the value of the investment which is not decreased by the calculated depreciation is returned to the public institution or the economic agent that has the asset in his patrimony, in order for them to increase accordingly the input value of the fixed tangible assets. In the minutes of the release-taking over, the value of the depreciation of the investment is also mentioned, in order for the owner to register the proper depreciation of the new input value.

f. The fixed tangible assets acquired from public institutions in terms of financial leasing contracts are depreciated in conformity with the law.

When determining the depreciation, there are 3 variables that must be kept in mind: the depreciable value, the useful life and the depreciation method. There are big differences between national and international accounting standards as far as the definition of these terms is concerned:

O.M.F.P. nr.1917 / 2005	IPSAS 17 „Tangible assets”
The depreciable value represents the carrying amount of the tangible asset which has to be systematically registered during the useful life of it. Romanian accounting regulations do not present the existence of residual value.	The depreciable value is the cost of the asset or another value which replaces the cost, which is decreased by the residual value.
The useful life is the period over which the asset is estimated to be used. The values for the useful life are presented in the Catalogue regarding the time for normal use of each asset, which is approved by decision of the Government (there is a gap between the minimum and the maximum time, therefore each institution can select a	The period of useful life is either the period of time in which the entity thinks it uses the asset or the number of production units or similar units that the entity believes will obtain from the use of the asset. The estimation of the useful life of the asset is a problem of professional judgement based on the experience of the entity with similar assets. There are certain variables which are taken into account when determining the useful life:

<p>O.M.F.P. nr.1917 / 2005</p> <p>number of years between these two values) [H.G. nr.2.139 / 2004]. Once the period of useful life is chosen, it cannot be changed. The number of years regarded as normal for the use of an asset by decision of the Government can be corrected with 20% more or less, if the approval of the officer exists. This situation can be applied in the case of modernization of fixed tangible assets, when their useful life can be increased by 20%. If the modernization took place after the end of the normal useful life, then a new period for the useful life will be determined this can be maximum 20% of the initial number of years, if the officer approves it. For those fixed assets whose normal period of useful life has not elapsed yet, if the dates of identification are known (the date for of the putting into operation, the normal period for use left), then the recovering of the input value is made through the period for normal use left. For the fixed assets whose useful life has expired or for whom the identification dates are not known, the period for normal use is determined by a technical committee or an independent technical expert.</p>	<p>IPSAS 17 „Tangible assets”</p> <p>The expected grade of use; this grade is calculated based on the estimated capacity of the asset or the physical output. The estimated physical wear, which depends on operational factors such as: the number of rounds in which the asset will be used and the program for the repairing and maintenance, the caring and maintenance of the asset when it is not exploited. The technical and commercial moral wear, which appears due to changes or improvements in production or due to a change in the demand on the market for the products or services generated by an asset. The legal regulations or other similar regulations concerning the use of an asset.</p>
<p>The accepted depreciation method is the linear one. The public institution is not allowed to select the method that illustrates in the best way the estimated model for the use of future economic benefits or possible services that the asset generates. The public institutions are forced to use only the linear method.</p>	<p>The accepted depreciation method: the linear method, the diminishing balance method of depreciation one and the production unit method. The entity selects the method that reflects the best the estimated consumption of future economic benefits or possible services incorporated into an asset, and must apply it consistently from one period to another. The method must be examined at least at every annual reporting date and, if some changes have occurred in the estimated model for the consumption of future economic benefits or possible services incorporated into an asset, then</p>

O.M.F.P. nr.1917 / 2005	IPSAS 17 „Tangible assets”
	the method must be changed in order to reflect the adjusted model. Such a change must be accounted for a change of the accounting estimation according to IPSAS 3 “accounting policies, changes of accounting estimates and errors”.

I. The linear depreciation method – refers to the calculation and the uniform allocation of the carrying amount of the fixed tangible and intangible assets over their useful life. According to this method, the calculation equations are:

The annual depreciation can be determined: (1) as a ratio between the posted accounting value/carrying value of the depreciable asset (VI) and the normal period of its useful life (DU) in years or (2) as the multiplication of the annual depreciation rate (Na) and the accounting value/carrying value of the depreciable asset (VI): (1) $A_a = \frac{VI}{DU}$ or: (2), $A_a = Na \times VI$

Where the calculation for the annual depreciation rate (Na) is: $Na = \frac{1}{DU} \times 100$

The monthly depreciation can be determined : (1) as a ration between the annual depreciation and number 12 (the number of months in a year) or (2) as a ratio between the posted accounting value/carrying value of the depreciable asset (VI) and the normal period of its useful life, expressed in months (DU_i): (1) $A_i = \frac{A_a}{12}$ or: (2) $A_i = \frac{VI}{DU_i}$

Example: determine the depreciation for a car, using the linear depreciation method, if the following dates are known: the useful life = 5 years (60 months), the carrying amount = 48 000 lei.

Version 1:

a. calculation of annual depreciation amount: $A_a = \frac{VI}{DU} = \frac{48.000}{5} = 9.600$ lei/year

b. calculation of monthly depreciation amount: $A_i = \frac{A_a}{12} = \frac{9.600}{12} = 800$ lei/month

Version 2:

a. calculation of depreciation rate: $Na = \frac{1}{DU} \times 100 = \frac{1}{5} \times 100 = 20\%$

b. calculation of annual depreciation amount: $A_a = Na \times VI = 20\% \times 48.000 = 9.600$

c. calculation of monthly depreciation amount: $A_i = \frac{A_a}{12} = \frac{9.600}{12} = 800$ lei/month

Version 3: $A_i = \frac{VI}{DU_i} = \frac{48.000}{60} = 800$ lei/month

II. Diminishing balance method of depreciation – results in a depreciation expense which decreases over the passing of the useful life. This method can be applied in two ways: the diminishing balance method with constant rate and variable depreciable base or diminishing balance method with variable rate and constant depreciable base.

1. The diminishing balance method of depreciation with constant rate and variable depreciation base: implies the calculation of a depreciation digressive rate by multiplying the

linear depreciation rate with a digression coefficient. The annual depreciation is determined by applying the digressive rate to the left depreciable value of the asset (this value decreases from one year to another), until the depreciation determined by this method becomes lower than the one determined using the linear method. From this moment on, the linear method of depreciation will be applied for the remaining depreciable value.

Example for determining the depreciation amount by using the diminishing balance method of depreciation with constant rate and variable depreciable base: a public institution holds a fixed tangible asset whose value is 100 000 lei and useful life = 5 years. The digressive coefficient is 2.

a. calculation of depreciation rate using the linear method:

$$Na = \frac{1}{DU} \times 100 = \frac{1}{5} \times 100 = 20\%$$

b. calculation of annual depreciation rate using the diminishing balance method of depreciation:

$$NDa = Na \times \text{coefficiet_degresion} = 20\% \times 2 = 40\%$$

c. annual depreciation amount (column 3) is determined like this:

$$Aa = \text{val_amort} \times NDa$$

The remaining depreciable value (column 4) is determined like this:

Remaining depreciable value = the depreciable value – the annual depreciation amount

Table 1. Example for the calculation of depreciation using the diminishing balance method of depreciation with constant rate and variable depreciable base

Elements Exercise	Depreciable value (lei)	Annual amount (lei)	Remaining depreciable value (lei)
N	100.000	100.000 x 40% = 40.000	100.000 – 40.000 = 60.000
N+1	60.000	60.000 x 40% = 24.000	60.000 – 24.000 = 36.000
N+2	36.000	36.000 x 40% = 14.400	36.000 – 14.400 = 21.600
N+3	21.600	21.600 / 2=10.800	21.600 – 10.800 = 10.800
N+4	10.800	100.000 x 40% = 40.000	10.800 – 10.800 = 0

Beginning with exercise N+3, we can see that, by applying the calculus in a regressive system (Aad) the depreciation that resulted from it is equal to 8.640 lei (21.600 x 40%= 8.640), whereas if we use the linear system (Aal), the depreciation will be equal to 10.800 lei (21.600/2=10.800). Seeing that the depreciation from the regressive system is smaller than that of the linear system (Aad<Aal), we will henceforth apply the linear system.

2. The regressive method using a variable rate and a fixed depreciation base: also known as the sum of utilization year's method. The depreciation value is constant and is given by the

asset's value and can be reduced by the residual value. The depreciation rate is regressive and is determined by the decreasing order of the employment years.

Example of finding out the depreciation using the variable rate and fixed depreciation base regressive method: A public institution has a fixed tangible asset of 120.000 lei, with an employment period of 5 years.

The depreciation rate (column 3) can be found using: $Ca = \text{years_of_employment} / \text{sum_years}$

The annual depreciation (column 4) can be found using: $Aa = \text{depreciation value} \times Ca$

Table 2. The depreciation calculus situation using the variable rate and fixed depreciation base regressive method

Elements Exercise	Depreciable value (lei)	Depreciation rate	Annual depreciation (lei)
1	100.000	$5/15 = 0,3(3)$	$100.000 \times 0,3(3) = 33.333,33$
2	100.000	$4/15 = 0,2(6)$	$100.000 \times 0,2(6) = 26.666,67$
3	100.000	$3/15 = 0,20$	$100.000 \times 0,200 = 20.000,00$
4	100.000	$2/15 = 0,13$	$100.000 \times 0,1(3) = 13.333,33$
5	100.000	$1/15 = 0,0(6)$	$100.000 \times 0,0(6) = 6.666,67$
Sum of years = 15	-	-	100.000

III. The production unit method – results in an expense regarding the depreciation using the expected utility or the asset production. This method should be used on those assets that depreciate as a result of its use, rather than its ageing or its irregular use [Țenovici, C. 2013, p. 108].

The annual depreciation will be calculated according to: $Aa_i = VI \times Ra_i$

The annual depreciation rate (Ra) can be solved using: $Ra_i = \frac{\text{Used capacity during year } i}{\text{Total capacity}} \times 100$

Example of depreciation calculus using the production unit method: A public institution has bought production equipment amounting to 240.000 lei, which shall be used to produce 480.000 special parts according to a 4-year contract. The delivery date of the parts is as follows: during the first year: 105.600 parts, during the second year: 168.000 parts, during the third year: 120.000 parts; and in the final year: 86.400 parts.

Table 3. Depreciation calculus situation using the variable rate and fixed depreciation base regressive method

Elements Exercise	Annual depreciation rate	Annual depreciation (lei)
Year I	$Ra_I = \frac{105.600}{480.000} \times 100 = 22\%$	$Aa_I = 240.000 \times 22\% = 52.800$
Year II	$Ra_{II} = \frac{168.000}{480.000} \times 100 = 35\%$	$Aa_{II} = 240.000 \times 35\% = 84.000$
Year III	$Ra_{III} = \frac{120.000}{480.000} \times 100 = 25\%$	$Aa_{III} = 240.000 \times 25\% = 60.000$
Year IV	$Ra_{IV} = \frac{86.400}{480.000} \times 100 = 18\%$	$Aa_{IV} = 240.000 \times 18\% = 43.200$

An entity should determine, for each report date, if there is any sign of asset depreciation (it is considered as such if its carrying amount surpasses its retrievable amount). If there is such a sign, the entity must estimate the retrievable amount of the mentioned asset. The retrievable amount of the service is defined as the highest amount when comparing the asset's real value after subtracting sale expenses to its amount in use.

After subtracting sale expenses from the real amount we determine the amount that can result from an asset's sale during a transaction conducted under objective conditions between aware and interested parties subtracted by the concession costs.

The amount in use is the updated value of the asset's remaining possible services. This value is considered to be the asset's depreciated replacement cost. This value is considered to be the reproduction (replication) or replacement cost, whichever one is smaller, subtracted by the depreciation cumulus retrieved from such a cost, and is used to reflect the possible services that have already occurred or the expired services of the asset.

The existence of such a sign that an asset is depreciated can emerge after the minimal analysis of the following clues [IFAC, 2009, p.647]:

a. External sources of information:

- The ceasing or the nearly ceasing of demands or needs of services offered by the asset;
- Long-term significant changes that have an adverse effect on the entity, changes that have already taken place or will take place in the near-by future, in either the technological, legislative or government politics field in which the entity operates.

b. Internal sources of information

- There is proof of the asset's physical deterioration;
- Long-term significant changes that have an adverse effect on the entity, changes that have already taken place or will take place in the near-by future and which have affected the employment rate or the manner in which the asset is used or is believed to be used in the future. These changes include observing that the asset is rendered unusable, plans of interruption and reorganization of the operation in charge of the mentioned asset or the concession of an asset before a predicted date;

- A decision on ceasing the construction of an asset before its finish or its functioning;
and

- Available proof from the internal report that indicates the fact that the performance of an asset's services is much inferior to that which had been predicted.

These include the existence of:

- a. Higher exploitation or maintenance asset costs than originally predicted in the initial budget; and
- b. Lowered levels of services and products provided by the asset in comparison to those initially predicted as a result of a diminished exploitation performance.

According to the guideline, there are other clues of asset depreciation than the aforementioned:

– During the period, the market value of the asset has sunk significantly more than predicted as a result of time or normal use; or

– A significant long-term decrease (not necessarily implying ceasing or near ceasing of the asset) in demand or need of the services offered by the asset.

According to O.M.F.P. no. 1917/2005, the depreciation of a fixed tangible asset can result from the following situations:

- Physical deterioration of the asset;
- Ceasing or near ceasing of demand or need of the services offered by the asset;
- The goods are rendered useless or must be given away;
- There is a decision regarding the ceasing of construction of an asset before actually finishing or functioning;
- Its performance regarding service providing is inferior to that initially predicted;
- Technology and legislative alterations in the field.

Evaluating a depreciation loss is possible as follows:

a. The retrievable value of an asset's service is lower than its carrying amount; the carrying amount shall be reduced to the retrievable amount of the service. This reduction is a depreciation loss that must be recognizable as profit or loss

b. When the estimated depreciation loss value is higher than the carrying amount of the asset to which it is referring, the entity must acknowledge a debt only if this is dictated by another IPSAS;

c. After acknowledging a depreciation loss, the asset's depreciation expense must be molded in the following period in order to assign the new value subtracted by its residual value (if such a value exists) to a systemic base for the remainder of its utility life.

For each report date, the entity must evaluate if there is such a sign that an asset depreciation loss found in the periods leading up to this date might not exist anymore or is very low, for, if such a sign does exist, the entity must estimate the retrievable amount of the asset's service. In order to determine if there are such signs that a depreciation loss found in the periods leading up to the report date must be reanalyzed, the entity must consider the following [IFAC, 2009, p.655]:

a. External sources of information:

- The reoccurrence of demand or need of the services offered by the asset;
- Significant long-term favourable changes that have taken place during the period or in the near-by future in the technological, legislative and government politics field in which the entity operates.

b. Internal sources of information:

- Significant long-term favourable changes that have taken place during the period or in the near-by future that have affected the utility levels or the manner in which the asset is used or is predicted to be used. These alterations include expenses for the improvement or the increase in performance of the asset or for the reorganizing of the operation of which the asset is part of.

–A decision of resuming an asset’s construction that has been previously ceased and upgrading the asset to a working condition;

– Available proof from the internal report that indicates the fact that the performance of an asset’s service is better than or will be significantly better than initially predicted.

According to the guideline, apart from the aforementioned signs of depreciation loss relapse, one can also mention:

1. A significant increase in the asset’s market value; or
2. A significant increase in long-term demand or need of the services offered by the asset.

The relapse of a depreciation loss is done accordingly:

a. An asset’s depreciation loss recognized in the previous periods must be resumed only if an alteration to the estimations used to determine the retrievable value of the asset’s service since its last depreciation loss acknowledgement has actually existed. The asset’s carrying amount should rise to the retrievable amount of the service, apart from the situation in which the risen carrying value of an asset which can be related to a depreciation loss relapse should not exceed the carrying amount which would have resulted if no asset depreciation loss for any of the previous periods had existed;

b. The asset’s depreciation loss relapse should be immediately characterized as either profit or loss;

c. After a depreciation loss relapse, the asset’s depreciation expenses should be moulded in the future in order for an updated carrying amount, subtracted by its residual value (if such a value exists), to be assigned to a systemic base for the remainder or its utility life.

Conclusions

From our previous analysis we have identified both converging and diverging elements regarding a future evaluation by applying the basic account treatment, as follows:

a. The depreciation treatment is similar between the two guidelines, but national law only allows the linear method of depreciation calculus, public institutions having thus no alternative in choosing the method which better reflects the predicted future economic benefits consumption pattern or the probable services embedded in the asset;

b. Common points of reference regarding the depreciated value exist, however Romanian accounting regulations do not agree with the existence of a retrievable amount;

c. There are significant differences between Romanian accounting regulations and existing guidelines in determining the utility life of tangible /fixed tangible assets;

d. National regulations imply the existence of both depreciable tangible assets, for which we have specific accounting treatment, and non-depreciable tangible assets, whose cost is entirely recognized on purchase or at delivery using the non-depreciable tangible assets’ expenses. This category of fixed assets is not found within the guidelines.

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