THE ISSUES RELATING TO REPORTING AND VALUATION OF LONG-TERM TANGIBLE FIXED ASSETS IN ACCOUNTING OF INDUSTRIAL ENTERPRISE

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Abstract:
The paper deals with valuation of the long-term tangible fixed assets in accounting. The aim of this paper is to compare different problems with valuation of the long-term tangible fixed assets and their perceptive comprehension in the course of processing financial analyses from financial statements.

Keywords: Long-term tangible fixed assets, assets valuation, repairs, technical revaluation, financial analysis

1. INTRODUCTION

The basic source of information for the financial analyses, as well as various other decision-making processes of any industrial enterprise is its accounting. The long-term tangible fixed assets represent a significant part of the assets of each industrial enterprise. There are certain material properties typical for long-term tangible fixed assets, as well as their long-term use of more than one year and their aptitude to get a certain level of valuation. While being used, the long-term tangible fixed assets are subject to gradual physical and moral wear, which is reflected in the loss of their original utility qualities they were originally acquired for, and consequently there is a decrease in such assets value.

The aim of this paper is to compare different ways of reporting and valuation of fixed assets in accordance with Czech accounting and tax laws and in accordance with International Accounting Standards IAS / IFRS and, in particular, to call attention to the problems and shortcomings that evaluation procedures under the Czech laws provide.

2. LONG-TERM TANGIBLE FIXED ASSETS IN THE CZECH REPUBLIC’S ACCOUNTING AND TAX LEGISLATURE

In the Czech Republic, the long-term tangible fixed assets fall under the regulation of many laws, in terms of both accounting, as well as tax. Accounting definition of long-term tangible fixed assets is based mainly on Czech Accounting Standard No. 013 - Intangible and tangible assets in relation to the Act No. 563/1991 Coll., Accounting Act, and Finance Ministry Decree No. 500/2002 Coll., implementing certain provisions of the Accounting Act. Tax view on long-term tangible fixed assets is regulated by the Act No. 586/1992 Coll., on income tax, as well as by the GFD Instruction No. D-6 aimed at a consistent approach in the application of certain provisions of the Income Tax Act.

The Czech accounting and tax laws use, in some individual cases, a different terminology for the long-term tangible fixed assets, and we can also identify somewhat different approach to such assets evaluation and depreciation methods. Accounting treatment of long-term tangible fixed assets is substantially broader than the concept of tax. Unlike the tax rules, the accounting rules do not set down any limit for entry price of the long-term tangible fixed assets (except technical revaluation), and the entry price depends only on the decision of an entity for tax purposes. However, it is understandable that most entities use in accounting for practical reasons limit for the entry price of long-term tangible fixed assets, such as defined for the tax purposes. Accounting depreciations are laid down by the entity in its own depreciation schedule, as opposed to the tax depreciations, which are regulated by the Income Tax Act. [1], [2]
3. COMPARISON OF APPROACHES TO LONG-TERM TANGIBLE FIXED ASSETS REPORTING PURSUANT TO THE CZECH LEGISLATURE AND IAS/IFRS

We consider it interesting to compare the approaches of the Czech accounting with the international accounting standards IAS/IFRS; therefore, we will focus our attention on them. The objective of these standards is not to lay down detailed procedures for such assets appropriate book-keeping, but namely to establish the rules for such assets appropriate reporting in the financial statements. The reporting of long-term tangible fixed assets is regulated by several standards, where dividing line for such assets’ distinction is, in particular, the purpose of their acquisition. If it is required that the financial statements, such as elaborated in accordance with the Czech accounting standards, are converted to IAS/IFRS, it is necessary to determine, which of the below standards should be employed. The reason behind such approach is the fact that the Czech accounting regulations do not possess any such dividing line, as well as the fact that there are different requirements regarding reporting of assets under each of described standard.

3.1 IAS 16 – Property, Plant and Equipment

IAS 16 outlines the accounting treatment for most types of property, plant and equipment, which the entity keeps with view to their utilization for manufacture or supply of goods and services, to be leased or rented to another entity or due to administrative reasons, where useful life of such property, plant and equipment is longer than one accounting period. The useful life in this case is considered to be the time period during which it is assumed that the entity would utilize such asset or expected quantity of products or similar units that can be gained by the entity through utilization of such asset. To be recognized as asset under IAS 16, such property, plant and equipment item must meet two prerequisites – probability of future economic benefits associated with the asset, which is to flow to the entity, and that the acquisition cost of the asset can be reliably measured.

This particular standard deals in detail with the spare parts, which can be exclusively for maintenance in particular plant and equipment item, or those, concerning whom the entity assumes useful life longer than one accounting period. All other spare parts, i.e. those that do not meet stipulated assumptions, are considered inventories. Thus, from the IAS/IFRS viewpoint, the spare parts position is significantly different from the Czech accounting legislature, which takes all spare parts, regardless of time or purpose of utilization, as inventories whose accounting treatment is that of current assets. [3]

3.2 IAS 40 – Investment Property

IAS 40 Investment Property applies to reporting, evaluation and disclosures as regards investment property – land and/or buildings – held by the owner or lessee rather to earn rentals or capital appreciation (or both) than for their utilization due to administrative reasons, for their sale within general entrepreneurship or for manufacture of products or rendering the services. [4] Therefore, the investments in non-movable assets are sometimes called “passive investments” in order to distinguish them from other, actively operated property items. [5] The difference between the Czech legislature and the IAS/IFRS lies in the fact that the Czech accounting regulations remain silent about investment property. Such assets are book-kept as normal, long-term tangible fixed assets.

3.3 IFRS 5 – Non-Current Assets Held for Sale and Discontinued Operations

IAS/IFRS 5 outlines how to account for non-current assets held for sale and discontinued operations. The category of non-current assets held for sale bears relation to a long-term property rather by virtue of its title only. From reporting view, herein involved are short-term items, entered individually. As far as these assets are concerned, the assumption is that their book value will be probably regained rather through the selling transaction than through continued operation. Thus, herein involved is the asset with all indications that it will be sold within a short period, mostly within one year. Such asset must be prepared for sale and the sale must be highly probable. [6]

The difference between the Czech rules and the IAS/IFRS, similarly as in case of the IAS 40, lies in the fact that the Czech accounting legislature refrains from separate reporting regarding any assets scheduled to be sold by the entity in a year to come, which approach is different from the IAS/IFRS, where such asset would be separated from remaining property and book-kept in the current assets category.
3.4 IAS 17 – Leases

IAS 17 Leases prescribes the accounting policies and disclosures applicable to leases, both for lessee and lessor. IAS 17 is closely related to IAS 16 Property, Plant and Equipment, because as of the moment when any long-term asset having been acquired through the financial leasing is entered into the balance sheet elaborated by the lessee in conformity with IAS 17, then such asset is treated according to IAS 16. A day, on which an item subject to leasing enters the entity’s assets, is a day, on which the lessee is entitled to use such item subject to leasing. [7]

A completely different view on the financial leasing exists between the Czech laws and accounting regulations and IAS/IFRS. The Czech accounting rules pay no particular attention to the leasing, which is subject to tax legislature only. In the first case, there are no stipulations in the entity’s balance sheet as regards both the assets having been acquired through the financial leasing and long-term liability arising therefrom. In the second case, the entity on the financial leasing validity commencement stipulates in its balance sheet, in the accruals account, a simple aggregation of leasing instalments against the liability such as arising from the leasing contract. In case of IAS/IFRS application, differently from the Czech approach, the subject matter of leasing is reported in the balance sheet in respective asset’s account against liability towards the leasing company.

4. VALUATION OF FIXED ASSETS

In principle, where the valuation of long-term tangible fixed assets in the Czech Republic’s accounting is concerned, certainly historical prices based upon the input prices are used. These are procurement prices, provided respective assets were, under certain conditions, acquired by means of purchasing, or own cost, provided respective assets were acquired for own account, or, as exception, a replacement cost. Valuation of long-term tangible fixed assets is increased by the cost incurred on such assets’ reconstruction and modernization. On the other hand, the repairs (including overhauls) and maintenance are always deemed an integral part of normal operating cost of given entity. The entity may create reserves for repairs, including those that are legal, i.e. deductible in view of the income tax, provided the rules such as set forth n the act on reserves were observed. In connection with the aforesaid it is necessary to stipulate that in practice it is sometimes difficult to distinguish in particular case between a repair and a technical revaluation. Wrong decision leads not only to a possible incorrect valuation of such assets, but also incorrect calculation of the income tax base. [1], [2]

4.1 Valuation Using Acquisition Cost

To perform valuation of long-term tangible fixed assets using acquisition cost is rather complicated task. The question is, which costs (expenses) connected with such asset’s acquisition, need to be involved and which need not. In principle, we can say that the acquisition cost (i.e. investment cost) involves the majority of costs associated with the acquisition of respective tangible fixed asset, basically with the exception of sanction costs, however, from the time viewpoint, in some cases, there is a limitation in time of putting such asset into use. It is with certain simplification that we can say that the price of tangible fixed asset should not include, in particular, contractual penalties and interest for delay amounts, or other contract-based sanctions, which from the Income Tax Act point of view are not considered as the expenses incurred on gaining, ensuring and sustaining the income, plus currency exchange rate variations.

4.2 Valuation Using Own Cost

Any long-term tangible fixed assets acquired on own account in the Czech Republic are subject to valuation using own cost, which category includes all direct and indirect costs incurred on such assets’ origination through own activities, possibly also costs of administrative nature.

4.3 Shortcomings and Problems of Tangible Fixed Assets Valuation

From the above it follows that any reader of the financial statements is unable to detect, directly from the balance sheet, the actual state of the tangible fixed assets wear, i.e. what is their physical and moral wear. Another problem is to emerge, when the entity uses historical valuation of such assets, what becomes
apparent, in particular, in older enterprises with a big volume of such assets. Such companies’ assets are very often undervalued; valuation of assets such as recognized and reported in accounting very often does not represent the real value for which such assets could have been newly acquired. Nonetheless, it just can be otherwise in case when such older assets were purchased, or if such older assets were acquired by virtue of non-monetary contribution.

Another shortcoming in respect of valuation relates to acquisition of long-term tangible fixed assets or intangible assets and exercise of technical revaluation thereof from grant because such grant is decreasing the value of property procured from such grant. In the Czech Republic’s accounting in such case the view of the tax laws prevails. For the sake of completeness, it is necessary to point that if the entity obtained respective grant for the purpose of cost coverage, it would account for it in other operation revenues in both material and time context with accounting for the costs incurred on given purpose. This might be also a subsidy from which the entity would finance a financial leasing concerning long-term tangible fixed assets.

In our view, it is incorrect that the ways and means of financing for acquisition, as well as contemporary methodology of recognition and reporting as regards repairs and technical revaluation of fixed assets can have an impact on their valuation amount in the balance sheet, and hence subsequently such assets’ accounting and tax depreciations and replacement value, not mentioning the problems arising, for example, if anybody would wish to arrange for the insurance of thus acquired assets against damages.

Whilst according to IAS/IFRS any repair that involves a replacement of a substantial proportion of given asset is book-kept as a part of long-term tangible fixed asset, according to the Czech accounting methodology, such repair is neutral in view of such asset's valuation. This can, namely as far as some big industrial facilities are involved, result in significant assets' undervaluation.

From the above problems it follows that the long-term tangible fixed assets deserve, with view to financial analyses in particular in industrial companies where they are allocated in greater volumes, justifiable attention. Such assets are valued basically in historical prices that no longer correspond to current pricing levels. This particular problem, however, may manifest itself inside the company in varying degrees of intensity, depending on how such property was acquired within the entity. Also, depreciation may not correspond to the actual state of wear, even though they are in the books, and therefore recognized in the financial statements accounting depreciation, not tax ones. The valuation of tangible fixed assets, as it follows from the aforesaid, is under the influence of, in particular, methodology of accounting for such assets’ repairs and technical revaluation, accounting for investment subsidies, financial leasing and, in some cases, also use of valuation difference towards acquired assets.

5. CONCLUSION

In summary, it is therefore clear that the above outlined procedures do not resolve the problem, which had historically originated in the entities in the Czech Republic, especially in long-term tangible fixed assets category. Here we can see, with view to the regulations in force in our country, a correct, yet in time order with view to the inflation and various accounting methods, a non-homogeneous valuation, which might lead to misleading results not only in financial analyses, but also in assessment of development plans. This fact is especially important in businesses that need to operate large volume of such assets, where typical examples are metallurgical enterprises. In our opinion, in the earlier years, the possibility of the revaluation of property remained unused, and therefore it is necessary to count with this aspect in the analyses of the development of these enterprises, both at sector, as well as corporate and internal level. For the purposes of intra-company management it is possible to perform an adjustment in valuation of long-term tangible fixed assets and use so called depreciation calculations. In addition to that, it should also be noted that according to the Czech accounting standards it is impossible to perform any revaluation of tangible fixed assets on a balance sheet day in prescribed manner, as it is allowed by the international accounting standards. The IAS/IFRS allow for, when certain conditions are met, revaluation of long-term tangible fixed assets. In our opinion, such approach ought to be incorporated in our country’s regulations for double-entry accounting of entrepreneurs.

LITERATURE:
[4] IAS 40 Investment Property
[6] IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
[7] IAS 17 Leases