THE IMPACT OF IFRS ON ROMANIAN REPORTING FOR LAND AND BUILDINGS

SAVA Raluca
Lucian Blaga University of Sibiu, Romania

Abstract:
The accounting treatment for land and buildings is different and is related to the purpose of holding/using the lands and constructions. Aligning the Romanian accounting system (RAS) to the international accounting standards and also to the European directives has manifested in terms of properties. In this article we turn our attention towards the changes regarding reporting properties in the financial statements for the BSE (Bucharest Stock Exchange) listed companies.

Key words: *property, investment property, financial reporting*

Companies hold land and buildings for a variety of reasons and there are a number of questions that need to be addressed before the company can determine the appropriate accounting treatment.

First of all, for a property to be recognized as an asset in a company's financial statements, it must meet the definition of an asset, as defined in the *Conceptual Framework for Financial Reporting 2011*: 'An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity'. Recognition is the process of incorporating in the statement of financial position an item that meets the definition of an asset and satisfies the following criteria: it is probable that any future economic benefit associated with the item will flow to or from the entity; and the item's cost or value can be measured with reliability.

Assuming a property is to be recognized as an asset in the statement of financial position, ***the next question involves its classification.*** Assets represented by lands and buildings are treated and presented in the financial statements of the companies in accordance with ***IAS 16 Property, IAS 2 Stocks, IAS 40 Investment property and IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*** according to their ownership / use in the property.

The entity needs to determine which standard applies to its property. Schematically choosing one of the standards listed above for their treatment can be represented in the next table.

1	Is the property being held (or being constructed) for use in the production or supply of goods or services, for rental to others, or for administrative purposes?	**Apply IAS 16**
2	Is the building owned by the entity (or held under a finance lease) and leased out under one or more operating leases? Is the building vacant but held to be leased out under one or more operating leases? Is the property being constructed by the entity for future use as investment property?	**Apply IAS 40**
3	Is the property being held (or being constructed) for sale in the ordinary course of business?	**Apply IAS 2**
4	Is the property classified as held for sale (outside the ordinary course of business)? • Will its carrying amount be recovered principally through a sale transaction rather than through continuing use? • Is the property available for immediate sale in its present condition subject only to terms that are usual and customary for the sale of such assets? • Is the sale highly probable?	**Apply IFRS 5**
5	Is a portion of the property being held for investment purposes and another portion being held for use in the production or supply of goods or services or for administrative purposes?	
	Can the portions be sold separately (or leased separately under a finance lease)?	**Apply IAS 16 or 40 to relevant portion**
	Where the portions cannot be sold separately, is the portion being held for use in the production or supply of goods or services or for administrative purposes significant?	**Apply IAS 16**
	Where the portions cannot be sold separately, is the portion being held for use in the production or supply of goods or services or for administrative purposes insignificant?	**Apply IAS 40**
6	Is the property owned by the entity but being leased to another entity under a finance lease, or is the property being leased by the entity under an operating lease?	**Not recognised as asset by entity**

Therefore, depending on the purpose of holding / using the lands and constructions, they are treated: as assets if the entity uses them to produce goods, to offer services or in administrative purposes; as real estates if they are owned as to be leased or to benefit from their increasing value, as stocks if the entity is going to sell them over the ordinary course of business, as a property held for sale if the entity is going to sell them outside the ordinary course of business.

After having established the appropriate classification of a property, ***the next problem involves the measurement of the property***. This means assigning monetary amounts at which the elements of the financial statements are to be recognized and reported: initial and subsequent (*Conceptual Framework for Financial Reporting 2011).*

	Initial Measurement	*Subsequent Measurement*
Owner-occupied Property (IAS 16)	-cost - can include the *purchase price* (less trade discounts or rebates), *import duties and other taxes* (if not recoverable); costs directly attributable to bringing the asset to	-either the *revaluation model* or *the cost model*, with the entity applying the chosen model to all of its properties. Where an entity chooses the cost model, it shall measure the

	the location & condition necessary for it to be capable of operating in the manner intended by management. The estimated costs of dismantling and removing the asset are also included, where an obligation exists to do so. - *the production cost*	property at its cost minus any accumulated depreciation and any accumulated impairment losses. Where an entity chooses the revaluation model, the property shall be carried at a revalued amount, being its fair value at the date of the revaluation minus any subsequent accumulated depreciation and subsequent accumulated impairment losses.
Investment Property (IAS 40)	- *the cost of a purchased investment property* includes its purchase price and any directly attributable expenditure, e.g. professional fees for legal services, property taxes, and other transaction costs. If the property is self-constructed, the *production cost* will be ascertained in a similar manner to a self-constructed asset accounted for under IAS 16.	-either the *fair value model* or the *cost model,* with the entity applying the chosen model to all of its properties. Where an entity chooses the cost model, it shall measure the property in accordance with IAS 16's requirements for that model. Where an entity chooses the fair value model, the property shall be carried at fair value. The fair value of an investment property shall reflect market conditions at the end of the reporting period.
Inventory (IAS 2)	-the *costs of purchase* may include the purchase price (minus the trade discounts and rebates), import duties and other taxes (if not recoverable), and transport and handling costs. *Costs of conversion* may include any direct costs of construction (e.g. direct labor and materials), allocation of variable production overheads (e.g. indirect materials & labor) and also the allocation of fixed production overheads (e.g. insurance, rental of plant). Other costs incurred in bringing the inventories to their present location and condition may include the cost of designing the building for a specific customer.	-a property classified as inventory shall be measured at the *lowest cost and net realizable value.* The net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
Property held for sale (IFRS 5).		-the lowest of its carrying amount and fair value minus the costs to sell. Immediately before the initial classification of the asset as held for sale, the carrying amount of the asset shall be written down to its recoverable amount

The standard **IAS 40 Investment Property** shall be used by all listed companies within the EU in the financial statement. IAS 40 has the purpose to show how investment properties shall be accounted for and what information needs to be included in the financial statement. The definition of the investment property according to IAS 40 is: *"The investment property is a property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn* *rentals or for capital appreciation or both*". (IAS 40, p. 5) The standard also tells us that the investment property can only be recognized as an asset in the balance sheet when it is likely that forthcoming economic benefits associated to the investment property will fall to the company. It is also necessary for the property cost to be reliably calculated.

The first valuation of the investment property shall be at cost model, which is the price of the purchase and the cost directly linked to the purchase. In the forthcoming valuation IAS 40 allows to choose between the fair value model and the cost model. The same model must be used for all of the investment property of the firm and a switch from the fair value model to the cost model is very unlikely to take place (http://www.iasplus.com). Expenses for maintenance of the property shall be accounted in the period it occurs as cost (IAS 40 p. 18). However, expenses that increase the value of the investment property shall be accounted as a part of the value of the property (IAS 40, p. 19).

At the point of the initial acquisition, the historical cost is equivalent to the fair value for the property. However, over time the two measures diverge. Fair value changes over time and thus, if there are changes in the fair value of the property, they are recognized in the financial reporting, and this information has the potential to provide valuable feedback to users. It can confirm or correct prior expectations formed by users based on current economic conditions and the most recent revaluation. For example, subsequent changes in the fair value of a firm's substantial investments in real estate could provide important feedback to investors and creditors. On the other hand, historical cost by definition does not change over time, providing limited feedback to users subsequent to acquisition. Books value, measured as historical cost less accumulated depreciation, may even provide feedback in the wrong direction. Books value systematically decrease over time even when the underlying asset is appreciating.

The financial statement must contain information about the chosen method. Information of the method to establish the fair value must be left in the financial statement. IASB recommends the use of the fair value model. A benefit from using the fair value model according to IASB is that it gives a more fair view of the value of the property than using the cost model. If the cost model is chosen, the fair value of the investment property still has to be left in a note in the financial statement. Despite the chosen model it shall be noted in what extension the fair value of the investment property is estimated by an independent external assessor.

Under RAS (Romanian Accounting System), public entities and large-sized companies applied the international standards from 2000-2005, at first experimentally and then compulsorily (from 2001). From 2006, IAS/IFRS enforcement is facultative, in the consolidated financial statements and from 2007 IFRS become compulsorily in the consolidated financial statements of the listed companies.

Until 2012, being in force OMFP 3055/2009, there were many differences in the classification of properties under RAS and IFRS for the listed companies.

		Assets with a finite useful life	Assets with a indefinite useful life	Investment property	Noncurrent assets held for sale	Inventories
Lands	RAS		x			
	IFRS		x	x	x	
Buildings	RAS	x				x
	IFRS	x		x	x	

(after Istrate C. 2012)

Starting with the financial exercise from 2012 for the companies listed on the BVB, it was issued the OMFP 1286 that brings significant changes in the manner of preparation of the individual financial statements of these companies regarding the presentation in the accounting system of the investment properties and of the non-current assets held for sale. In accordance with this order the RAS acknowledge the investment properties as a component of the current assets applying the provisions of IAS 40.

If by 2012 they formed a part of the non-current assets (land and buildings) without being distinctly highlighted in the accounting system, the chart of accounts applicable to such companies now contains special accounts in terms of reflecting the investment properties, the investment properties under construction, the amortization, the impairments, the gains or losses from investment properties made by companies. So according to OMPF 1286/2012 the individual annual financial statements starting with 2012 represent distinctly the data relating to the investment properties for companies listed on the BSE.

In the BSE category 1 are assigned 28 companies. Banks, investment funds and other financial institutions were excluded from the sample because of the asset structure differences (8 were excluded). In addition, 2 companies suspended from trading were also excluded, remaining a sample of 18 companies. Their financial statements were studied and in the case of 6 companies, as part of the non-current assets, investment properties were found. For this we first analyzed the share of the investment properties in the total land and buildings owned by societies regardless of their purpose (use or rental). For 2012, the real estate investments held by these six companies represent 36.44% of all land and buildings in heritage, which we consider to be a significant percentage. So the introduction of IAS 40 brings to the accounting information users an added value in terms of the structure and use of land and buildings by companies. Further analyzing the valuation method of the investment properties at the end of the financial exercise we found that all six companies have chosen the fair value model for presenting the investment properties in the annual financial statements resorting to external evaluators to establish these values, most evaluations being conducted at the end of the financial year, 2012.

We performed the same analysis for the companies classified in category 2 from the BSE. From a total of 51 companies we excluded those suspended, leaving for analysis a total of 47 companies. Their financial statements were studied and in the case of 17 companies we found as part of non-current assets the investment properties. For these we first analyzed the share of the investment properties in the total of land and buildings owned by societies regardless of their purpose (use or rental). For the year 2012, the investment properties held by these 17 companies represent 20.16% of all land and buildings in heritage. In this case also we consider that the investment properties held a significant share from the total land and buildings owned by the companies analyzed. Furthermore, by analyzing the evaluation method of the investment properties at the end of the financial exercise, we found that 16 out of the 17 companies have chosen the fair value model for presenting the investment properties in the annual financial statements by referring to external evaluators to establish these values. Most assessments were made at the end of the financial exercise 2012. A single company has chosen the cost model which is also allowed by IAS 40. Comparing the results obtained by using the fair value model for valuing land and buildings from previous studies (Istrate 2012) we notice that the percentage of companies that report using the fair value model increased from 85% in 2007 to 96% in 2012.

Introducing the IAS 40 provisions and the IFRS 5 in the Romanian accounting regulations, although it is currently available only for the stock listed companies, show benefits, bringing additional accounting information necessary to external users. For the Romanian accounting system we appreciate as being required a broadening of the application scope of these standards for the other companies also (unlisted at the stock).

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Ordin 1286/2012, OMFP 3055/2009

IAS 16 - Property, Plant and Equipment, IAS 2 – Inventories, IAS 40 – Investment Property.