

ACCOUNTING, AMORTIZATION, FISCALITY – A TRIO STILL GENERATING DEBATE

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Abstract: Although, in the fight with inflation, Romania has lately obtained indubitable success, the inflation rate in our country continues to be high. Although in the Romania of the year 2007 we speak of a one-digit inflation rate, still, it continues to represent a danger, both at the micro economical level and at the macro economical one. In this context we feel it is still useful to approach the problems regarding the amortization of the immobilized actives, both in relationship with inflation as well as in relation with the fiscal implications that derive of it.

Key words: **accounting, amortization, fiscality, IFRS**

Even if, in what the battle with inflation is concerned, Romania has been obtaining indubitable victories lately, the inflation rate in our country is still high. Although in the Romania of the year 2007 we speak of a one-digit inflation rate, still, it continues to represent a danger, both at the micro economical level and at the macro economical one. Moreover, the latest increases in the prices of food, generated by the existence of an agricultural production that didn't meet the expectations, the increase of the price of electricity, natural gas, and certain salary claims, we believe put in danger the level BNR aims at for inflation in 2007 and not only.

In this context we feel it is still useful to approach the problems regarding the amortization of the immobilized actives, both in relationship with inflation as well as in relation with the fiscal implications that derive of it.

As we are well aware of, when the historical cost is found in the base for the calculation of the amortization, the amount resulted at the end of the period of amortization is, as result of its expression in constant currency, inferior to the initial investment, the difference being even more pronounced when the amortization period is longer, and when the inflation is stronger. This situation represents one of the limits of accounting in historical costs and implicitly of the amortization, calculated in such conditions, as a division mechanism on the result of the exercise of the cost of the immobilizations.

The amortization methodology shows the evolution of the amortization rhythm and of the values not yet amortized for the life duration of the immobilizations. The decision of the enterprises to choose one or another of the approved fiscal methods takes into account their development strategy, as well as the state's attitude towards the investment process in a certain period of time. No matter what amortization methodology is used, we feel it must meet several criteria, such as:

- the amortization must be included in the cost of the products or of the services provided by the company, in a sufficient degree, so as not to lead neither to the appearance of fictive profits, nor the their artificial decrease, because the registering of amortizations under the real value of the

depreciation determines exaggerated profits, which, in turn, create the distribution of fictive dividends and the payment of over-assessed taxes, while the inclusion of exaggerated amortizations in the costs generate the creation of resources for self-funding, in the case of the regular payment of the products/services, but will affect the interests of the stock-holders, as well as the company's image in the eyes of potential investors;

- the amortization plan must give the possibility of the uniform influence of the costs of the products/services provided;
- to limit the losses resulting from the moral decay;
- the amortizations must give the possibility for the renewal of the equipment in the rhythm decided by the company, meaning their perpetual correlation with the replacement value.

In the case of unstable economies or periods of time, from an economical point of view, monetary and financial, the increase of the inflation rate gravely impacts on the reproduction of the fixed capital, and the amortization loses its role in this respect. In the case of a decrease of the purchase power of the currency, and of a rapid increase of the prices, the calculation of the amortization with the historical cost as its base doesn't allow the efficient fulfillment of the function of maintaining the integrity of the productive capital any more and of the measuring of the depreciation, thus resulting a loss manifested in two directions:

- the existence of a final result superior to the real one because of the inclusion in the costs of underestimated amortizations, an aspect which leads to fictive profits, and from here on, to the obligation of paying over-rated taxes and dividends;
- the impossibility of renewing, in an identical way, of the production capacities, especially given the accelerated technical progress the identical reconstruction is not sufficient any more in order to maintain the production force.

So, the effect of the interaction between inflation and amortization is the de-capitalization of the company, first of all, by using the available funds as a result of the distribution of fictive dividends and paying artificially increased taxes, and second of all, by the impossibility of maintaining the production capacity with the replacement of used goods.

When the problem of attenuating the interaction between amortization, inflation and fiscality is discussed, we feel that several factors must be taken into account:

♦ **The optimal dimensioning of the production capacities**, as well as the determination of economical production flows, which can ensure a shorter period of time from the launch of the raw material into production to when it's transformed into the product, with the purpose of increasing the efficiency of the use of the immobilized actives and by means of the expenses they transmit to the cost of the created utilities.

♦ **The optimal dimensioning of the amortization periods**. We feel that when determining the amortization periods one must seek the optimizing of the conflictive aspects which co-interest, on the one hand, the competitive interest of the company in relation with the competition, which claims the increase of the periods, and, on the other hand, the financing interest for the reproduction of immobilizations, according to which the shortening of the amortization periods is requested. From this point of view the problem analyzes, in our opinion, has, under inflation, certain particularities, meaning that when the economy is marked by a galloping increase of the prices the

interest of the economical agents claims the decrease of the amortization period, because the negative effects of de-capitalization can be overcome with much more difficulty than the effects of the decrease of the product competitive character, especially because in an inflationist economy many times the price increases can be attributed to this phenomenon, even if they are not always justified.

Of course we mustn't omit the fact that amortization, by conception and formula, is a process with fiscal implications, a reason for which we mustn't also neglect the state's interest as an entity seeking to attract increasingly bigger income for the national budget. We feel that this conflict that exists between amortization and inflation is also fueled by its fiscal component, because the state's interest aims at diminishing the expenses with amortization, so that the tax on income paid by the company is larger. Although such a policy, on the short term, produces the increase of budget income, on the medium and on the long run determines major unbalances at the micro economical level, which later on propagate to the macro economical level.

We feel that under persistent inflation, as is the case of Romania, the state's fiscal interest mustn't rule, which is why we say that in such an economical environment, the normal periods of functioning must be adjusted and adapted so that to reach a compromise regarding the financing interest of the capital reproduction, manifested at the level of the economical agents, and the interest to collect as much income possible to the state budget.

Of course we mustn't neglect the need to cover the budget expenses, but we believe that the effects of de-capitalization of companies, as a result of the impossibility to reproduce capital, are very damaging, first of all for the economical agents, and later on, for the state, the Romanian economy being a very good example of that.

Another aspect we feel must be dealt with is the practical way to determine the normal durations of use. From the beginning we will state our adhesion to the point of view that in a modern market economy the government intervention, through the mechanism of central rules, in determining amortization periods, has negative implications, through the amortization, on the competitive abilities of the companies. That is why starting from the premise that amortization is a problem that must be dealt with through company strategy, we feel that determining the periods of use must be based on professional reasoning.

In our country the normal durations of use of the fixed means are determined at the central level, by a decision of the Government¹², and are periodically revised. The law we have mentioned states, *"The normal duration of functioning is the duration of functioning when the entering value of the fixed means on the way of amortization is recovered from a fiscal point of view. So, the normal duration of functioning of the physical is smaller than that of the fixed means."*

Practicing the centralized method of determining the amortization period, in a time when inflation has been very high and has had damaging effects because, in our opinion, three essential objectives, whose importance is given by the order in which they are presented, have not been mentioned:

- increasing the possibilities to rebuild the fixed capital through amortization, considering that even when a rapid increase of the prices appears and when

¹² HG nr. 2139/2004 for approving the Catalogue for the classification and the normal duration of functioning of the fixed means, M.O. nr. 46 of 13.01.2005.

a system of accounting using historical costs is employed, amortization significantly diminishes its role as financier of the social reproduction;

- maintaining at a level as high as possible of the competitive character of the products realized, by including a normal amortization in the costs;
- ensuring / satisfying the state's fiscal interest, by payment, by the fiscal agents, of a correct tax on income.

At first glance we might say that the three objectives are contradictory and exclude each other, but we feel that complying with the first one is essential because, in our opinion, we thus create the premises for achieving the other two objectives. Maintaining capital is a condition sine qua non, ensuring the continuity of activity, under inflation, setting as a main objective of an entrepreneur to keep a constant level of the productive force.

Even if with the new Catalog regarding classification and the normal duration of functioning of the fix means time-frames are decided, from which the economical agents can choose the duration they think is optimal considering their economical necessities, still we believe that in many cases, the minimum limit set by law doesn't coincide with the point of view of the production specialists/technicians.

◆ For reaching the objectives mentioned above the regime of amortization used can also contribute. In our country the companies are obligated to amortize the corporal and non-corporal immobilizations in compliance to the legislation applied¹³, using one of the linear, digressive or accelerated amortization regimes.

From these methods, it is believed that the linear amortization regime ensures the calculation of a rational and economical quantum of amortization. But if analyzed in the context of an economy constantly influenced by inflation, the linear amortization meets in the least degree the interests of the economical agents, on the one hand, and, on the other hand, contributes in a significant way to the distorting of the information provided by the historical cost accounting, because:

- the amortization calculated in a linear regime, representing a constant value for the entire period of amortization, is most affected by the decrease of the purchasing power of the currency in which it expressed, and this influences in a damaging way the company's ability of financing the reproduction of its capital;
- presenting in the financial situations of the immobilized actives at netto accounting values, resulted from the deduction from the entry value of the linear amortization, contributes to the accentuating of the phenomenon of desynchronization and to the depreciation of the quality of information, because these values are no longer up to date, but express a past purchasing power, and thus useless in the present.

Of course the other two amortization regimes stated in the national laws have all the inconveniences mentioned above, but it is believed that under inflation the digressive amortization, especially the AD2 type, and the accelerated amortization are better suited for the interests of the economical agents. In our opinion, these two amortization methods contribute better to the attenuation of the decapitalization phenomenon, but without removing it, but in what the quality of the information provided by the financial situations is concerned, regarding the fix capital, under

¹³ Law 15/1994 regarding the amortization of the capital immobilized in corporal and non-corporal actives, republished, with subsequent modifications, M.O. nr. 242 of 31.05.1999.

inflation, we can say that the flaws of the linear amortization are still present. Practically, none of the amortization methods stated by the Romanian law allow accounting in historical costs to provide, when the economy is marked by inflation, correct and true information regarding the company's fixed actives.

We believe that a brief comparison between IAS 16 "Corporal Immobilizations" and the national legislation is useful, which can show a few elements we think are significant for the theme we are discussing.

Thus, the standard mentioned above defines amortization as being "*the systematic allocation of the amortizable value of an active for the entire duration of its active life*". So, according to the definition, the expense with amortization must be systematically registered for the entire duration of useful existence of the active, so that the value that must be amortized to be recognized in the profit and loss account in the period when the economical benefits of the active are used.

One of the new aspects brought by the analyzed rule, compared to the national legislation, the way of determining the amortizable value, represented by the cost of the active, or the re-evaluated value, diminished by its residual value. The Romanian laws do not recognize the concept of residual value of an active, and in many cases it can be a neglectable or null value, because of the tendency to use the actives for the entire duration of their useful life, and do not accept the amortization deductions by considering the reevaluations done to the amortizable fixed means. Any way there are situations when the actives can have residual values, when the company decides, for various reasons that it should not continue to use them up to the end of their economical life.

When conceiving the law we are studying, the residual value is the amount the company expects to obtain from reselling the goods at the end of the use period, an amount diminished by the values of cession expenses. So, considering the concept of residual value, the standard suggests that amortization mustn't be calculated based on the total cost of the active, only if the company intends to preserve the goods until the end of its life period, the deduction of the residual value produces the diminishing of amortization, so, a result increase.

In synthesis, we can observe that in what the amortization of immobilized actives is concerned, the international laws have certain particularities compared to our own laws that currently regulate this aspect, such as:

The IAS 16 "Corporal Immobilizations" is different from the Romanian laws, for determining the amortization related to an immobilization the company being the one to decide the method of amortization, estimating, also, the duration of useful life. That is why the standard appeals to professional reasoning, not only at the beginning of the "life" of an active, but also along the way, when a review of the life duration might be necessary or even the employment of a different amortization method;

The notion of useful life duration of each active subjected to amortization is used, which must be **estimated** after analyzing several factors: the estimated employment level by the company (based on the reproduction capacity or the estimated production), the physical decay estimated according to the exploitation conditions, moral decay, juridical boundaries as to the possibility of using the active, while the Romanian legislation uses the term of normal functioning period when the entry value of the fixed means is recovered;

The amortization methods which will be used must be chosen according to how future benefits are generated, associated to the active, stipulating the need to apply the

chosen method constantly, according to the principle of method permanency, except for modifications that require the use of another amortization method;

The useful life duration and the amortization methods must be periodically revised and modified, if the present estimated are significantly different from the previous ones, while the national laws state that, once the normal duration of functioning is decided, it stays unchanged until the integral recovery of its entry value;

In deciding the formula for calculating amortization a new concept applies, residual value.

The difference between the legislation for problems such as amortization and certain articles of the international standards, are in many ways essential only if we speak of aspects regarding amortization periods, choosing the amortization method, reviewing the amortization periods and methods etc. The essential difference between the Romanian laws regarding amortization and the international recommendations is, first of all, the exercising, by specialists, of the professional reasoning at a level that, for now, has yet to find an equivalent in the national laws. This is, in our opinion, a very important aspect, with numerous implications on the quality of information provided by accounting, especially under inflation.

On the other hand, analyzing the alternative accounting treatments allowed by Romanian laws, we note that reevaluation has been the “the main alternative treatments” to update the value of the fixed means.

In this context we feel that several aspects, which, in our opinion, are very important and must be considered as work hypothesis when approaching the problem of amortization under inflation must be studied:

- amortization, as regulated by the laws of the country, induces under inflation a series of negative effects, both on the company’s patrimony, and on the financial situations, which provide information on the financial position, which forces to use alternative accounting treatments in order to diminish such effects;
- reevaluation, as alternative treatment, hasn’t been the best way to fight efficiently the effects of inflation on amortization, because of the many limits of this procedure, at least in the forma applied in Romania;
- evaluation through methods intended to consider inflation was allowed only to the companies which adopted the accounting method based on applying the International Accounting Standard, but these companies, because of the fiscal laws, haven’t been stimulated to apply such treatments;
- inflation can produce to companies, keeping the proportions, the same effects no matter the category they belong to: large, average, micro or macro enterprises;

Considering this situation, we feel that when inflation has been dominating the national economical environment, for a considerable period of time, the average national economical level for a considerable period of time, the accounting information, generally, and the one about the amortization of immobilizations, in particular, has been affected at the quality level.

Because of the inflation rate, which in Romania is still high, this state of facts is also maintained and accentuated by the fact that the fiscal authority disposed certain rules as to the deductibility from the tax on profit of the expenses with the amortization of immobilized actives. So, according to the amortization regime used, and to the fiscal facilities, we can distinguish between accounting amortization and fiscal one.

By analyzing the laws¹⁴ we can see that differences between accounting amortization and fiscal one can appear when, from an accounting point of view, amortization is done for a period of time smaller than the normal duration of functioning.

This means that Romanian companies, if they want to deduce from the taxes on profit the amortization of the entire accounting value, must respect, as amortization period, the normal duration of functioning imposed by the fiscal authority.

On the other hand, we mustn't omit that deductions are allowed without considering the accounting reevaluations of the fixed means, which makes us wonder to what degree the economical agents will be interested to perform such operations, considering the rather high degree of complexity they involve.

In our opinion, the way in which amortization is regulated in Romania can be considered one of the most eloquent examples of "fiscal pollution" of accounting, with many negative implications in economy, especially under inflation.

In this context, we feel a new method already used internationally could be applied to the Romanian economical agents, meaning the updating of inflation amortization or the annual recalculation of the amortization according to the replacement value of the immobilized actives.

The method has several variants, according to the conceptions regarding the replacement value.

If by replacement value we understand the cost or the price of an identical good as that being exploited, at the end of the usage period, the prediction is random, for which we cannot accurately predict, the rhythm of currency depreciation and the rhythm of the technical progress.

If the replacement value is understood as the cost of the reconstruction of equipment, considered at the end of each exercise, the method becomes more accurate. In this case there are different ways to calculate amortization, if the update is done successively only for the considered exercise, or is reconstructed from the moment the equipment enters the company's active.

Thus, some authors feel that when calculating the amortization based on the annual replacement value, it is advised to immediately place the amounts in other immobilized actives or even to temporarily finance the stock of circulating actives, considering the currency depreciation. When the amortization is calculated based on the annual replacement value, but reconstructing it from the moment the machine is first used, it is recommended to preserve the amounts in a fund to be used at the end of the duration of use, in order to replace the used fix means.

Even if applying this method determines the inclusion in the cost of a bigger amortization, still, it gives the possibility to reach the goal of amortization that of renewal factor for the equipment. Of course, under the fiscal aspect, the method cannot be preferred, as long as it distances from the fiscal amortization as stated by the current laws. In this context we feel that, under inflation, the state's fiscal interest mustn't be neglected, neither the companies' interest to create the necessary sources for investment, because inflation, even if it determines an increase of the budget income, on the short term, on the long run, as a result of decapitalization, has negative effects

¹⁴ Law 571/2003 on the Fiscal Code, with subsequent modifications, Official Monitor nr. 927/2003.

which impact the micro economical level, which reflect on the sources attracted to the state budget.

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