

Property, Plant and equipment

IAS 16

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Objective

- ▶ The objective of IAS16 is to prescribe the accounting treatment for property, plant, and equipment (PPE), including
 - ▶ Timing of the recognition, derecognition, and amortization;
 - ▶ Determination of the carrying amount of the assets under the cost model and their valuation model;
 - ▶ Depreciation charges and impairment losses to be recognized in profit or loss; and
 - ▶ Disclosure requirements

Scope

- ▶ IAS 16 prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment
- ▶ It applies to all PPE , except
 - a. PPE classified as held for sale (IFRS 5)
 - b. biological assets related to agricultural activity (IAS 41)
 - c. the recognition and measurement of exploration and evaluation assets (IFRS 6)
 - d. mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources

Note:

- IAS 16 applies to PPE used to develop or maintain the exempted assets
- The leased/government grant PPE follows the IAS 16 accounting treatment.
- Cost model for investment property (IAS 40) follows the IAS 16 cost accounting model

Definition

- ▶ Property, plant and equipment:
 - ▶ Tangible items,
 - ▶ Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes;
 - ▶ Expected to be used during more than one period
- ▶ An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount
- ▶ **Recoverable amount** is the higher of an asset's fair value less costs to sell and its value in use.
- ▶ Useful life is:
 - ✓ the period over which an asset is expected to be available for use by an entity; or
 - ✓ the number of production or similar units expected to be obtained from the asset by an entity.
- ▶ **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.
- ▶ **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.
- ▶ **Residual value** is the estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal (assuming the asset is already aged and in the condition expected at the end of its useful life). If the intent is to scrap an asset, it will have no residual value

Recognition

- ▶ Cost of an item of PPE shall be recognised as an asset if, and only if:
 - it is probable that future economic benefits associated with the item will flow to the entity; and
 - the cost of the item can be measured reliably.
- ▶ An entity evaluates all its PPEs costs under the recognition principle as at the time they are incurred. These costs include costs incurred initially and subsequently on the asset.
- ▶ Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed ...Major spare parts and stand-by equipment qualifies as PPE when used for more than one year or can be used only in connection with item of PPE
- ▶ IAS 16 applies to Items of PPE acquired for safety or environmental reasons. The carrying amount of such PPE and others must be test for impairment.
- ▶ Costs of the day-to-day servicing of the item are **not capitalised** but rather expense as incurred in P or L

Component approach

- ▶ An asset consists of several components with different useful lives, so some components have to be replaced several times, or even regularly, during the total useful life.
- ▶ Account separately for each material component with different useful lives of pattern of depreciation
 - ▶ Recognise in PPE the cost of replacing part of such an item when that cost is incurred.
 - ▶ Carrying amounts of those parts replaced are derecognised.

Subsequent Cost

- ▶ Major part replacement at regular intervals and frequently/non recurring replacements are capitalised as part of the PPE and the carrying amount of the replaced parts derecognised.
- ▶ The condition of continuing to operate a PPE may require a major inspections regardless of whether parts of the item are replaced. Such costs are capitalised as part of the PPE and the carrying amount of the previous inspection is derecognized (estimate of future inspection cost may be as an indication of the carrying amount of the PPE)
- ▶ **Measurement at Recognition**
- ▶ PPE that qualifies for recognition as an asset shall be measured at its cost. Elements of cost;
 - ❑ its purchase price, including import duties and non-refundable purchase taxes, after
 - ▶ deducting trade discounts and rebates.
 - ❑ any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
 - ❑ the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

- ▶ directly attributable Costs are:
 - I. costs of employee benefits (as defined in IAS 19 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
 - II. costs of site preparation;
 - III. initial delivery and handling costs;
 - IV. installation and assembly costs;
 - V. costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
 - VI. professional fees.

- ▶ Examples of costs not capitalized as item of PPE are:
 - costs of opening a new facility;
 - costs of introducing a new product or service;
 - initial operating losses
 - costs of relocating or reorganising part or all of an entity's operations.
 - Cost/income incurred on a Ready PPE that is yet to be brought into use or is operated at less than full capacity.
 - costs of conducting business in a new location or with a new class of customer; and
 - administration and other general overhead costs.

- ▶ Recognition of costs in the carrying amount of PPE ceases when the item is in the necessary location and condition and capable of operating as intended by management.

Measurement after initial recognition

Cost or revaluation model

The policy chosen shall be applied to an entire class of PPE.

Cost model

PPE is carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation model

PPE whose fair value can be measured reliably shall be carried at a revalued amount being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Revaluation shall be done with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Revaluation Model

- Surpluses
 - Recognise increases in other comprehensive income, unless they reverse a previous revaluation decrease earlier recognised in p or L.
- ▶ Deficits
 - ▶ Recognise decreases in statement of profit or loss unless they reverse a previous increase.

Revaluation rules

Asset value increases: Recognize in other comprehensive income and as “revaluation surplus” in equity.

Asset value increases, but reverses a prior revaluation decrease: Recognize as profit to the extent that it reverses a revaluation decrease previously recognized in profit or loss.

Asset value decreases: Recognize as a loss in profit or loss.

Asset value decreases, but credit balance exists in the revaluation surplus for the asset: Recognize in other comprehensive income to the extent of any revaluation surplus for the asset, with any excess recognized as a loss in profit or loss.

- ✓ Revaluation surplus can be transferred to retained earnings when asset is derecognized
- ✓ Revaluation surplus can be transferred to retained earnings when asset is being used (difference in depreciation charge arising from using original cost versus revalued amount)

Depreciation cont'd

- ▶ **Useful life**
 - ▶ **Expected usage by reference to the asset's expected capacity or physical output.**
 - ▶ **Expected physical wear and tear**
 - ▶ **Number of shifts for which the asset is to be used**
 - ▶ **Repair and maintenance programme**
 - ▶ **Technical or commercial obsolescence**
 - ▶ **Legal or similar limits on the use of the asset.**
 - ▶ **Must reassess annually – change in estimate**

Exercise

- ▶ Clark Company owns a building that cost \$800,000 with useful life of 8 years. The building has accumulated depreciation of \$200,000 at the end of 2 years when Clark revalues the building to its current fair value of \$1,000,000. at the end of year 5, the building was revalued to \$150,000

- ▶ **Question 1**

Provide the journal entry for revaluation of the asset.

Exercise 2

Purchase price of land 250,000

Stamp duty 5,000

Legal fees 10,000

Site preparation and clearance 18,000

Materials 100,000

Labour (period 1 April 20X7 to 1 July 20X8) 150,000

Architect's fees 20,000

General overheads 30,000

The following information is also relevant:

- Materials costs were greater than anticipated. On investigation, it was found that materials costing N10 million had been spoiled and therefore wasted and a further N15 million was incurred as a result of faulty design work
- As a result of these problems, work on the building ceased for a fortnight during October 20X7 and it is estimated that approximately N9 million of the labour costs relate to this period.
- The building was completed on 1 July 20X8 and occupied on 1 September 20X8.
- **You are required to calculate the cost of the building that will be included in tangible non-current asset additions.**