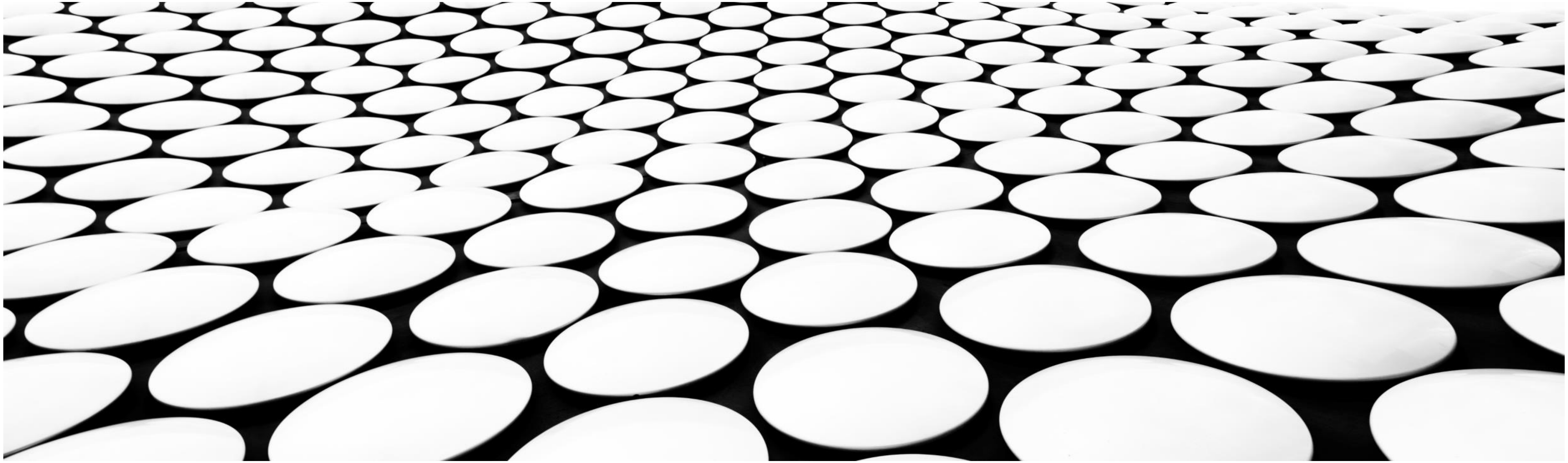
INTERNATIONAL FINANCIAL REPORTING STANDARDS PROPERTY, PLANT AND EQUIPMENT (IAS 16)

BY B D CHATTERJEE *FCA, ACMA, ACS, DIP (IFR) ACCA – UNITED KINGDOM*



PROPERTY, PLANT AND EQUIPMENT (IAS 16)

DEFINITIONS

- *Carrying amount* is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.
- *Cost is* the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Ind AS e.g. IFRS 2 Share-based Payment.
- *Depreciable amount* is the cost of an asset, or other amount substituted for cost, less its residual value.
- *Depreciation* is the systematic allocation of the depreciable amount of an asset over its useful life.

- *Entity-specific value* is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.
- *Fair value* is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
- An *impairment loss* is the amount by which the carrying amount of an asset exceeds its recoverable amount.
- *Property, plant and equipment* are tangible items that:
  (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  (b)are expected to be used during more than one period.

- *Recoverable amount* is the *higher* of an asset's fair value less costs to sell and its value in use.

- The *residual value of an asset* is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

- *Useful life* ***is:***
  (a) the period over which an asset is expected to be available for use by an entity; or
  (b) the number of production or similar units expected to be obtained from the asset by an entity.

TANGIBLE NON-CURRENT ASSET (TNCA)

TNCA = Tangible (Physical / touchable) + Non-current (other than current) asset

Current assets are assets

- Realized (sold/consumed) in entities Normal operating cycle
- Which are held for trading
- Like cash / cash equivalent (Unless restricted from being exchanged)
- Is expected to realize within 12 months After Balance Sheet date

Recognition of Non-current assets

Future economic benefits
Will flow to entity

Cost of an item can be
Measured reliably

Costs which can be capitalized
Purchase price
Cost incurred for bringing the asset to the location & condition for its intended use
Initial estimate of restoring the site

Costs which cannot be capitalized
Overhead cost, cost of launching the product
Expenses on opening new businesses & relocating the existing one
Initial losses when assets operate at low capacity & cost of incidental operations

CONSTITUENTS OF COST

Costs	Constituents of costs
Purchase price	• **Cash price** equivalent at recognition date i.e. Purchase price – trade discounts – rebates + duties and non-refundable taxes
Costs directly attributable to bringing the asset to its location and in the condition so as to make it available for its intended use	• Costs of employee benefits (as per Ind AS 19 Employee benefits), arising from construction or acquisition of property, plant and equipment • Costs of preparing the site • Delivery and handling costs (freight and delivery charge) • Installation costs (e.g. wages to instal machinery) • Testing costs net of revenue generated, such as sale proceeds of material produced during a test run • Professional fees (architect's fees)
Initial estimate of the costs of dismantling and removing the item and restoration of site	• Either when the item is acquired or • As a consequence of having used the item during a particular period for purposes

COSTS TO BE EXCLUDED

Examples

- Administration and general overhead
- Cost of launching a new product or service
- Expenses on opening a new business facility or expenses related to an inaugural function
- Cost of relocating – shifting factory consequent to statutory order
- Initial losses when the asset operates at lower capacity
- Costs of incidental operations not necessary to bring the asset to its required condition and location.

PURCHASE PRICE IN EXCHANGE TRANSACTIONS

When the asset is acquired not in exchange for money but in exchange for non-monetary asset……

…………then it may be necessary to measure the value.

Fair Value or Carrying amount

- Cost of assets involved in exchange is determined at fair value (of the Asset received or the asset given up) unless:

a) The transaction ***lacks commercial substance***
b) The fair value of ***neither of the assets is reliably measureable***.

- If any of the above mentioned exceptions apply and therefore the asset cannot be valued at fair-value, then the cost of the asset acquired is measured at the **carrying amount** of the asset given up.

RECOGNITION AND MEASUREMENT OF SUBSEQUENT COSTS

Item	Narrative
Capital expenditure	Expenditure which ***enhances the revenue generating capacity*** of the asset so that it works more efficiently or the useful life is extended.
Revenue expenditure	Expenditure which ***maintains the existing capacity of the asset,*** in order that it can work efficiently.
Subsequent costs – capital and revenue expenditure	*a)* ***Cost of day-to-day servicing of an asset*** is treated as revenue expenditure and charged to Statement of Profit or Loss and not included in the carrying cost of the asset. *b)* ***Cost of replacements***: - at regular intervals - at less frequent intervals - at occasional intervals – i.e. non-recurring replacements These are recognised as capital expenditure and added to carrying value of asset. Once the new parts are recognized, the old parts are replaced and de-recognized and removed from Balance Sheet. Certain plant and equipment (e.g. aircraft, engines, turbines etc) are required to carry out major inspection and overhauling expenses on a periodic basis. The above principle would apply to these cases as well.

RECOGNITION AND MEASUREMENT OF SUBSEQUENT COSTS

- Property, Plant and equipment is initially recognized at historical cost. Subsequently
  - they are carried either at cost less accumulated depreciation and any accumulated impairment loss or
  - revalued amount less subsequent accumulated depreciation and any accumulated impairment loss . Revaluation amount is the fair value at date of valuation.
- The measurement is applied consistently to entire class of property, plant & equipment
- Any revaluation increase is credited directly to the revaluation surplus in equity, unless it reverses any revaluation decrease previously recognized in Profit or loss.
- Any revaluation decrease is directly debited to Profit or loss. However any subsequent revaluation decrease is debited directly to revaluation surplus in equity to the extent of the original credit in revaluation surplus with respect to that asset.

RECOGNITION AND MEASUREMENT OF SUBSEQUENT COSTS

Comparison of cost model vs revaluation model

Cost model	**Revaluation model**
Valuation of carrying amount Cost is taken as starting point	Valuation of carrying amount Revalued amount is taken as starting point since it replaces cost
Accumulated depreciation and impairment losses are deducted from initial recognition of carrying value	Accumulated depreciation and impairment losses are deducted *subsequent to the revaluation date*

REVALUATION OF ASSETS

First time

- Increase in value → Credit revaluation reserve
- Decrease in value → Debit PL A/c

Previously revalued

Increase
If previous revaluation has led to increase in value, credit Revaluation reserve

Increase
If present increase is linked to previous decrease,
a) credit revenue to that extent and
b) balance to revaluation reserve

Decrease
If present decrease is linked to previous increase, a) charge revaluation reserve to that extent and b) balance to revenue

Decrease
If previous Revaluation had also led to decrease in value, charge revenue

SALE OF NON-CURRENT ASSET

ASSET	TREATMENT
Sold/No longer used	Revaluation surplus Transferred to retained earning
Still in use	A part of the revaluation Surplus can be transferred to retained earning

Part transferred = <u>difference between depreciation based on historical cost & on revalued amount</u>

DEPRECIATION AND IMPAIRMENT

- Depreciation is applied on component basis separately against each item of asset.
- Depreciable amount is allocated on systematic basis over the useful life of the asset
- Impairment is recognized in accordance with IAS 36 on “Impairment of assets”.
- The gain or loss on derecognition of an asset is the difference between
  - net disposal proceeds and
  - the carrying amount of the item and it is included in P&L account.
- If the entity rents some assets and later ceases to rent them , the assets should be transferred to inventories in their carrying amounts as they are now held for sale.

Note: Please refer IFRS 5 on non current assets held for sale and discontinued operations

DEPRECIATION OF NON-CURRENT TANGIBLE ASSET

Depreciation is a systematic allocation of depreciable amount of an asset over useful life

Item	Narrative
Treatment of accumulated depreciation after revaluation	a) The accumulated depreciation needs to be restated proportionately so that the carrying amount of the asset after revaluation equals its revalued amount. b) The accumulated depreciation is eliminated against the gross carrying amount of the asset, with the net amount restated to its revalued amount. This method is more in use.

DEPRECIATION METHODS

- **The straight line method:**

  This result is a constant change over the useful life if the asset's residual value does not change

- **The reducing (diminishing) balance method:**

  This results in decreasing change over the useful life

- **The units of production method:**

  This results in a change based on expected use or output

DEPRECIATION OF ASSETS HAVING ONE OR MORE SIGNIFICANT PARTS

Each part of an item of property, plant and equipment with a cost that is significant in relation with the total cost of the item should be depreciated separately. IAS 16 Para 43

If the cost of an asset is

Significant when compared to cost of total asset then

That part should be depreciated separately

Insignificant parts are depreciated together

THANK YOU!