

IAS 16 Property , Plant and Equipment

Background



- ❑ IAS 16 became operational in 1983
- ❑ Major amendments have been made several times including 1998, 2003, 2008, 2012, 2013, 2014
- ❑ The objective of this Standard is to 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.
- ❑ Key issues
 - ❑ the recognition of the assets;
 - ❑ the determination of their carrying amounts and;
 - ❑ the depreciation charges and impairment losses to be recognised in relation to them

Scope



- ☐ This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.
- ☐ The standard excludes:
 - ☐ Property, plant and equipment classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
 - ☐ Biological assets related to agricultural activity (IAS 41 Agriculture);
 - ☐ The recognition and measurement of exploration and evaluation assets (IFRS 6 Exploration for and Evaluation of Mineral Resources)
 - ☐ Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources

Scope (Cont'd)



- ❑ However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in the previous slide
- ❑ For example, IAS 17 Leases requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by IAS 16

Key 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
- ❑ **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

Key Definitions (Cont'd)



- ☐ **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date
- ☐ **An impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount
- ☐ **Plant Property and Equipment** are tangible items that:
 - ☐ held for use in the production or supply of goods or services, for rental to others, or for administrative purposes
 - ☐ 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

Key Definitions (Cont'd)



- ❑ 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:
 - ❑ the period over which an asset is expected to be available for use by an entity
 - ❑ the number of production or similar units expected to be obtained from the asset by an entity

Recognition



- ❑ Items of property, plant, and equipment should be recognised as assets when it is probable that:
 - ❑ it is probable that the future economic benefits associated with the asset will flow to the entity, and
 - ❑ the cost of the asset can be measured reliably.
- ❑ This recognition principle is applied to all property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.
- ❑ IAS 16 does not prescribe the unit of measure for recognition – what constitutes an item of property, plant, and equipment

Recognition (Cont'd)



- ❑ If the cost model is used each part of an item of property, plant, and equipment with a cost that is significant in relation to the total cost of the item must be depreciated separately
- ❑ IAS 16 recognises that parts of some items of property, plant, and equipment may require replacement at regular intervals
- ❑ The carrying amount of an item of property, plant, and equipment will include the cost of replacing the part of such an item when that cost is incurred if the recognition criteria (future benefits and measurement reliability) are met

Recognition (Cont'd)



Initial Costs

- ❑ Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets
- ❑ Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.
- ❑ For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals
- ❑ Related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with IAS 36 Impairment of Assets.

Recognition (Cont'd)



Subsequent Costs

- ❑ Under the recognition principle, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item.
- ❑ Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts
- ❑ The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.
- ❑ Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement.
- ❑ An entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met.

Recognition (Cont'd)



Subsequent Costs

- ❑ A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced
- ❑ When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied
- ❑ Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised
- ❑ This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed

Recognition (Cont'd)



Measurement at Recognition

- ❑ An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost

Elements of cost

- ❑ The cost of an item of property, plant and equipment comprises:
 - ❑ 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.

Recognition (Cont'd)



Examples of directly attributable costs

- ☐ directly from the construction or acquisition of the item of property, plant and equipment
- ☐ costs of site preparation
- ☐ initial delivery and handling costs
- ☐ installation and assembly costs
- ☐ 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)
- ☐ professional fees

Examples of are not costs of an item of property, plant and equipment

- ☐ costs of opening a new facility
- ☐ costs of introducing a new product or service (including costs of advertising and promotional activities)
- ☐ costs of conducting business in a new location or with a new class of customer (including costs of staff training as well as administration and general overhead costs)

Initial Measurement



- ☐ An item of property, plant and equipment should initially be recorded at cost.
- ☐ Cost includes all costs necessary to bring the asset to working condition for its intended use.
- ☐ This would include not only its original purchase price but also costs of site preparation, delivery and handling, installation, related professional fees for architects and engineers, and the estimated cost of dismantling and removing the asset and restoring the site
- ☐ If payment for an item of property, plant, and equipment is deferred, interest at a market rate must be recognised or imputed

Initial Measurement (Cont'd)



- ☐ If an asset is acquired in exchange for another asset (whether similar or dissimilar in nature), the cost will be measured at the fair value unless
 - ☐ (a) the exchange transaction lacks commercial substance
 - ☐ (b) the fair value of neither the asset received nor the asset given up is reliably measurable.
- ☐ If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up

Measurement Subsequent to Initial Recognition



- ❑ IAS 16 permits two accounting models:
- ❑ Cost model. The asset is carried at cost less accumulated depreciation and impairment.
- ❑ Revaluation model. The asset is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably

Measurement Subsequent to Initial Recognition (Cont'd)



Revaluation Model

- ☐ Revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date
- ☐ If an item is revalued, the entire class of assets to which that asset belongs should be revalued
- ☐ Revalued assets are depreciated in the same way as under the cost model
- ☐ If a revaluation results in an increase in value, it should be credited to other comprehensive income and accumulated in equity under the heading "revaluation surplus" unless it represents the reversal of a revaluation decrease of the same asset previously recognised as an expense, in which case it should be recognised in profit or loss

Measurement Subsequent to Initial Recognition (Cont'd)



Revaluation Model

- ❑ A decrease arising as a result of a revaluation should be recognised as an expense to the extent that it exceeds any amount previously credited to the revaluation surplus relating to the same asset
- ❑ When a revalued asset is disposed of, any revaluation surplus may be transferred directly to retained earnings, or it may be left in equity under the heading revaluation surplus. The transfer to retained earnings should not be made through profit or loss

Depreciation (Cost and Revaluation Models)



- ❑ The depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life
- ❑ The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate.
- ❑ The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity
- ❑ a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate
- ❑ The depreciation method should be reviewed at least annually and, if the pattern of consumption of benefits has changed, the depreciation method should be changed prospectively as a change in estimate
- ❑ Expected future reductions in selling prices could be indicative of a higher rate of consumption of the future economic benefits embodied in an asset
- ❑ Depreciation should be charged to profit or loss, unless it is included in the carrying amount of another asset
- ❑ Depreciation begins when the asset is available for use and continues until the asset is derecognised, even if it is idle

Depreciation (Cost and Revaluation Models)



- ❑ A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life
- ❑ These methods include ;
- ❑ **straight-line method:** results in a constant charge over the useful life if the asset's residual value does not change
- ❑ **the diminishing balance method :** results in a decreasing charge over the useful life
- ❑ **the units of production method:** results in a charge based on the expected use or output
- ❑ The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.
- ❑ That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

Recoverability of Carrying Amount



- ❑ IAS 16 requires impairment testing and, if necessary, recognition for property, plant, and equipment. An item of property, plant, or equipment shall not be carried at more than recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.
- ❑ Any claim for compensation from third parties for impairment is included in profit or loss when the claim becomes receivable

Derecognition (retirements and disposals)



- ❑ An asset should be removed from the statement of financial position on disposal or when it is withdrawn from use and no future economic benefits are expected from its disposal. The gain or loss on disposal is the difference between the proceeds and the carrying amount and should be recognised in profit and loss
- ❑ If an entity rents some assets and then ceases to rent them, the assets should be transferred to inventories at their carrying amounts as they become held for sale in the ordinary course of business

Disclosure



Information about each class of property, plant and equipment

- ☐ For each class of property, plant, and equipment, disclose:
 - ☐ basis for measuring carrying amount
 - ☐ depreciation method(s) used
 - ☐ useful lives or depreciation rates
 - ☐ gross carrying amount and accumulated depreciation and impairment losses
 - ☐ reconciliation of the carrying amount at the beginning and the end of the period, showing:
 - ☐ Additions
 - ☐ Disposals
 - ☐ acquisitions through business combinations

Disclosure (Cont'd)



- ☐ revaluation increases or decreases
- ☐ impairment losses
- ☐ reversals of impairment losses
- ☐ depreciation
- ☐ net foreign exchange differences on translation
- ☐ other movements

Disclosure (Cont'd)



The following disclosures are also required

- ☐ restrictions on title and items pledged as security for liabilities
- ☐ expenditures to construct property, plant, and equipment during the period
- ☐ contractual commitments to acquire property, plant, and equipment
- ☐ compensation from third parties for items of property, plant, and equipment that were impaired, lost or given up that is included in profit or loss.

Disclosure (Cont'd)



Required Disclosures for Revalued PPE

- ☐ the effective date of the revaluation
- ☐ whether an independent valuer was involved
- ☐ for each revalued class of property, the carrying amount that would have been recognised had the assets been carried under the cost model
- ☐ the revaluation surplus, including changes during the period and any restrictions on the distribution of the balance to shareholders..

