



Accounting for Changes in Depreciation Methods / Useful Life / Residual value.

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Relevant Standards



IAS 16 PPE

IPSAS 17 PPE

IFRS for SMES Section 17 PPE

Depreciation Review



Review at least at each reporting date

- Residual value
- Useful life
- Depreciation method

Changes are changes in estimate, so adjust current and future periods only

DEPRECIATION



- Applies only to fixed assets.
- The whole cost of the fixed assets must be spread over its useful life.
- The portion of the cost allocated to a particular accounting period is charged as an expense against revenue (Matching principle).
- This portion of the cost is called Depreciation

CAUSES OF DEPRECIATION



☐ Physical Deterioration

☐ Obsolescence

☐ Depletion of an asset

☐ Passage of Time

METHODS OF DEPRECIATION



- Straight-Line Units-of-output
- Reducing Balance
- Double-declining-balance
- Sum-of-the-years-digits

STRAIGHT LINE METHOD



(I) A machine X costs \$20,000 is expected to last 4 years. At the end of the 4th year, it can be sold for \$2,000 as scrap. (Scrap value is the same as residual value.)

Depreciation per year = $\frac{\text{Original cost} - \text{Residual value}}{\text{Expected useful life}}$ $(20,000 - 2,000) / 4 = \$4,500$

REDUCING BALANCE METHOD



Depreciation expense

Rate of depreciation X Net book value at beginning of accounting period

Net book value = Original cost - Accumulated depreciation

Changes in Depreciation Method



Method of depreciation once selected is consistently applied

Change in method of Depreciation is undertaken in the following circumstances:

- Compliance with change in accounting standards
- For more appropriate presentation of the financial statement

Treatment Of Change In Method



A Change in Method of Depreciation is a change in accounting policy

A change in accounting policy is accounted for retrospectively

Retrospective Application



Depreciation is Re-calculated in accordance with the new method

There arises either a surplus or deficiency when such recalculation is made.

These changes are charged to retained earnings with comparative adjustment and restatement of opening balances

Changes in Estimated Useful Life



Changes in estimated useful life are treated as a change in accounting estimate which is amended prospectively

Prospective Application



The remaining carrying amount of the asset is charged to revenue over the revised remaining useful life

Change In Residual Value



Changes in residual value are treated as a change in accounting estimate which is amended prospectively

Prospective Application



The remaining carrying amount of the asset is charged to revenue over the revised remaining useful life

Depreciation on Addition/ Extension



Any addition or extension becomes an integral part of the existing asset. Hence it is depreciated over the remaining useful life of the asset.

Other Issues - PPE

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

Revaluation Model



- ▶ Revaluations should be carried out regularly
- ▶ 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

Revaluation Increase



Where a revaluation results in an increase

- ▶ It is recognized under other comprehensive income and accumulated in equity
- ▶ unless it represents the reversal of a revaluation decrease of the same asset previously recognized as an expense, in which case it should be recognized in profit or loss.

Revaluation Decrease



- ▶ A decrease arising as a result of a revaluation should be recognized as an expense to the extent that it exceeds any amount previously credited to the revaluation surplus relating to the same asset.

Cost Model



Where the cost model is adopted for a class of PPE all items in that class will be carried at cost less accumulated depreciation and impairment losses

Depreciation



- ▶ The depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life
- ▶ Residual value should be reviewed annually
- ▶ Depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity

Depreciation Based On Revenue Generated By An Activity



Amendment (Clarification) – 1 January 2016

Depreciation method based on revenue that is generated by an activity that includes the use of an asset is not appropriate.

Depreciation should reflect the pattern of consumption of an asset's expected future economic benefits

Restoration and Similar Liabilities (1)



Changes due to a change in

Estimated timing

Estimated amount of payments

Discount rate

Added to / deducted from cost of underlying asset
and depreciated prospectively over remaining useful
life

Restoration Costs (2)



Changes in liability added/deducted from asset cost in current period

No negative carrying amount possible; any excess recognised immediately in profit or loss

Increase in carrying amount triggers consideration of impairment, including, if necessary, calculation of recoverable amount

Definitions and scope



- ❖ A Bearer plant -A living plant that:
 - a. Is used in the production or supply of agricultural produce
 - b. Is expected to bear produce for more than one period, and
 - c. Has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

Examples Bearer Plants



- Tea bushes
- Coffee trees
- Sugar cane roots
- Fruit trees

Treatment Of Bearer Plants



- A bearer plant should be accounted for as property plant and equipment in accordance with IAS 16
- Initial measurement is at cost
- Subsequent measurement is in line with either cost model or revaluation model

End



GOD BLESS YOU ALL