



IAS 16 PROPERTY, PLANT AND EQUIPMENT

IAS 16 Property, Plant and Equipment

Definition

PPE are tangible items that are:

- ❖ Held for use in production and supply of goods and services, or
- ❖ Used for administrative purpose, and
- ❖ Used For rental to others,
- ❖ Expected to use for more than a period

Objectives

The objective of IAS 16 is to prescribe the accounting treatment for property, plant, and equipment. The principal issues are

- ❖ recognition of assets,
- ❖ the determination of their carrying amounts, and
- ❖ the depreciation charges and impairment losses to be recognized in relation to them.

Scope

IAS 16 applies to all PPE except:

- ❖ Assets held for sale (IFRS 5)
- ❖ Biological assets (IAS 41)
- ❖ Exploration and evaluation assets (IFRS 6)
- ❖ Investment property (IAS 40)
- ❖ Mineral rights and mineral reserves

Recognition

An item of property, plant and equipment is only recognized if :

- ❖ 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***.

Measurement

Initial Measurement

Amendments to IAS 16 (Effective 1 January 2016)

Revenue based depreciation is prohibited and Depreciation method reflects the pattern in which future economic benefits are expected to be consumed.

Initial measurement of PPE should be done **at Cost**

Cost of PPE Comprises of

- ❖ Purchase price including Import duties and taxes (Non-refundable) after deducting trade discounts and rebates.
- ❖ Any costs directly attributable to bring the asset to its present location and conditions to be able to operate and use it in the specified manner (**Intended Use**)
- ❖ Present value of dismantling cost (Estimates)

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 or (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.

Also, if both values are not known then the asset cannot be recognised in the books

Subsequent Measurement

Cost Model

The asset is carried at cost less accumulated depreciation and impairment losses

Revaluation Model

Depreciation

- ❖ The depreciable amount is allocated on a systematic basis over the asset's useful life.
- ❖ The residual value, the useful life and the depreciation method of an asset are reviewed annually at reporting date
- ❖ Depreciation commences when the asset is available for use.
- ❖ Changes in residual value, depreciation method and useful life are changes in estimates
- ❖ Depreciation is charged to profit or loss, unless included in carrying amount of asset

Revaluation Model

The asset is carried at a revalued amount, being its fair value at the date of the revaluation, less subsequent depreciation, provided that fair value can be measured reliably.

- ❖ Revaluation frequency depends upon the changes in fair value of the items measured, provided that annual revaluation for volatile items or intervals between 3 - 5 years
- ❖ If an item is revalued, the entire class of assets to be revalued
- ❖ Depreciation on revalued asset is charged in the same way as in cost model
- ❖ The net carrying amount of the asset is adjusted to the revalued amount and either
 - The gross carrying amount is adjusted in a manner consistent with the net carrying amount. And accumulated depreciation is adjusted to equal the difference between the gross and net carrying amount; or
 - Accumulated depreciation is eliminated against the gross carrying amount.
- ❖ Depreciation on revaluation amount should be transferred between reserves
- ❖ An increase in value is credited to other comprehensive income in reserves and surplus, unless it represents the reversal of a revaluation decrease of the same asset previously recognised as an expense; in this case the increase in value is recognised in profit or loss.

Accounting of Components

- ❖ Significant parts/components are required to be depreciated over their estimated useful life
- ❖ Costs of replacing components are capitalised
- ❖ Continued operation of an item of property, plant and equipment (PPE) may require 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 PPE as a replacement if the recognition criteria are satisfied.
- ❖ Spare parts, stand-by or servicing equipment are classified as PPE when they meet the definition of PPE, and are classified as inventory when definition is not met.

Disposal of Asset

- ❖ Remove the asset from the statement of financial position on disposal or when 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 is recognised in profit or loss
- ❖ When a revalued asset is disposed of, any revaluation surplus may be transferred directly to retained earnings. The transfer to retained earnings is not made through profit or loss.

Disclosure Requirements

- ❖ Measurement basis used for determining the gross carrying amount
- ❖ Depreciation methods used
- ❖ Useful lives or the depreciation rates used
- ❖ Gross carrying amount and the accumulated depreciation at the beginning and end of the period
- ❖ A reconciliation of the carrying amount at the beginning and end of the period showing: additions / assets classified as held for sale or included in a disposal group classified as held for sale / other disposals / acquisitions through business combinations / changes resulting from revaluations and from impairment losses recognised or reversed in other comprehensive / impairment losses recognised in profit or loss / impairment losses reversed in profit or loss / depreciation / exchange differences / other changes.
- ❖ Existence and amounts of restrictions on title, and PPE pledged as security for liabilities.
- ❖ Contractual commitments for the acquisition of PPE.

Latest Developments

In June 2017, the IASB issued proposed amendments to IAS 16 regarding proceeds before intended use. The amendments would prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity would recognise those sales proceeds in profit or loss. Comments are due 19 October 2017.

Illustrative disclosure

Example 1 :

On 1 March 201X ABC co. acquired a machine under the following terms:

	AED
List price of machine	82,000
Import duty	1,500
Delivery fees	2,050
Electrical installation costs	9,500
Pre-production testing	4,900
Purchase of a five-year maintenance contract with Plant	7,000

In addition to the above information ABC Co was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5% if payment for the machine was received within one month of purchase. ABC Co paid for the plant on 25 March 201X.

Solution:

List price	82,000
Less: trade discount (10%)	(8,200)
	73,800
Import duty	1,500
Delivery fees	2,050
Electrical installation costs	9,500
Pre-production testing	4,900
Total amount to be capitalised at 1 March	91,750

The maintenance contract of AED 7,000 is an expense and therefore should be spread over a five-year period in accordance with the accruals concept and taken to the income statement. If the AED 7,000 has been paid in full, then some of this cost will represent a prepayment. In addition the settlement discount received of AED 3,690 (AED 73,800 x 5%) is to be shown as other income in the income statement.

EXAMPLE 2

An item of plant was purchased on 1 April 20X0 for \$200,000 and is being depreciated at 25% on a reducing balance basis. Prepare the extracts of the financial statements for the year ended 31 March 20X2.

Solution:

Income statement extract

Depreciation expense AED 37,500

Statement of financial position extract

Plant
(200,000 – 50,000 – 37,500) AED 112,500

Working for depreciation:

31/03/09		Cost 200,000
		Depreciation – 25% (50,000)
		Carrying value 150,000
31/03/10		Carrying value 150,000
		Depreciation – 25% (37,500)
		Carrying value 112,500

Disclaimer:

This communication contains general information only, and none of M Al Ali Auditing, its member firms, or their related entities (collectively, the "M Al Ali Auditing network") is, by means of this communication, rendering professional advice or services. No entity in the M Al Ali Auditing network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.