Chapter 10 IAS 16 – Property, Plant and Equipment

Principles in Brief

¶10-010 Basic Principles including Objective

- The objective of IAS 16 is to prescribe the accounting treatment for property, plant, and equipment. The principal issues are the recognition of assets, the determination of their carrying amounts, and the depreciation charges and impairment losses that need to be recognised in relation to them.
- Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used for more than one period.
- 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.
- 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.
- For subsequent measurement, IAS 16 gives two options in accounting models. The entity may use either cost model or revaluation model.
- 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 under IAS 8.
- The carrying value of PPE should be tested for impairment at each reporting dates as per principles laid down in IAS 38 - Impairment of Assets.

Principles in Practice

¶10-020 Scope

This Standard should be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.

IAS 16 does not apply to:

- Assets classified as held for sale in accordance with IFRS 5
- Exploration and evaluation assets (IFRS 6)
- Biological assets related to agricultural activity (IAS 41)
- Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources

¶10-030 Key Definitions

- **Property, plant and equipment** are items that:
  - are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  - are expected to be used during more than one period.
- **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.
- **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.
- **Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.
- **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.

¶10-040 Recognition

Property, plant, and equipment should be recognised as assets when:

- 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.

¶10-050 Component Cost Approach

IAS 16 does not prescribe the unit of measure for recognition as to what constitutes an item of property, plant, and equipment. 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.

¶10-060 Major Replacements

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 are met.

The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of IAS 16.

¶10-070 Major Inspections/Overhauls

An item of property, plant, and equipment may require regular major inspections/ overhaul for faults, regardless of whether parts of the item are replaced. When each major inspection/overhaul 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. The same is amortised over the overhaul cycle.

¶10-080 Initial Measurement

An item of property, plant and equipment is initially recorded at cost. Cost includes all costs necessary to bring the asset to working condition for its intended use.

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

(a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates

(b) 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

(c) 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

(d) Borrowing cost of a qualifying asset (IAS 23)

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.

¶10-090 Measurement Subsequent to Initial Recognition

IAS 16 permits two accounting models:

- Cost Model, wherein the asset is carried at cost *less* accumulated depreciation and impairment.

- Revaluation Model, where 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.

Conditions of Revaluation Model

- **Revalue the entire class of assets**

  If an item is revalued, the entire class of assets to which that asset belongs should also be revalued.

- **Frequency of revaluation**

  The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.

  Frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. In those cases, it may be necessary to revalue the item only every three or five years.

- **Depreciation on revalued assets**

  No carving out of depreciation charge, in respect of depreciation on cost base and depreciation on revaluation base, is permitted in the Income Statement. In other words, revalued assets are to be depreciated in the same way as under the cost model.

- **Treatment of revaluation surplus**

  If a revaluation results in an increase in value, it should be credited to other comprehensive income and accumulated in equity

  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 and cannot be routed through the income statement.

¶10-100 Depreciation (both for 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 under IAS 8.
- The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity.
- 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 under IAS 8.

- Depreciation should be charged to the income statement, 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.

¶10-110 Impairment

An item of property, plant, or equipment should not be carried at more than recoverable amount as per IAS 36. 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.

¶10-120 Derecogniton (Retirements and Disposals)

An asset should be removed from the balance sheet 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 the income statement.

¶10-130 Major Disclosures

Disclosure for Each Class of Property, Plant and Equipment

The financial statements should disclose:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;

(iii) acquisitions through business combinations;

(iv) increases or decreases resulting from revaluations under paragraphs 31, 39 and 40 and from impairment losses recognised or reversed directly in equity in accordance with IAS 36;

(v) impairment losses recognised in profit or loss in accordance with IAS 36;

(vi) impairment losses reversed in profit or loss in accordance with IAS 36;

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and other changes.

Disclosures for Property, Plant, and Equipment stated at Revalued Amounts

The financial statements should disclose:

(a) the effective date of the revaluation

(b) whether an independent valuer was involved

(c) the methods and significant assumptions used in estimating fair values

(d) the extent to which fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques

(e) the carrying amount that would have been recognised had the assets been carried under the cost model for each revalued class of property

(f) the revaluation surplus, including changes during the period and any restrictions on the distribution of the balance to shareholders

The following also need to be disclosed:

(a) restrictions on title

(b) expenditures to construct property, plant, and equipment during the period

(c) contractual commitments to acquire property, plant, and equipment

(d) 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

Multiple Choice Questions

1. Residual value is specifically:

(a) Scrap value

(b) The gross cash amount that you will receive from the ultimate sale of the asset, at the end of its life

(c) The net cash amount that you will receive from the ultimate sale of the asset, at the end of its life

2. ABC Ltd owns a fleet of over 100 cars and 20 ships. It operates in a capital-intensive industry and thus has significant other property, plant, and equipment that it carries in its books. It decided to revalue its property, plant, and equipment. The company's accountant has suggested the alternatives that follow. Which one of the options should ABC Ltd select in order to be in line with the provisions of IAS 16?

(a) Revalue only one-half of each class of PPE, as that method is less cumbersome and easy compared to revaluing all assets together.

(b) Since assets are being revalued regularly, there is no need to depreciate.

(c) Revalue one ship at a time, as it is easier than revaluing all ships together.

(d) Revalue entire class of PPE.