

# Measurement of tangible non-current assets essay sample



**ASSIGN  
BUSTER**

As the business environment grows and companies find new ways to expand into their respective – or even new – markets, it is important that reporting standards stay up to date with changes and continue to assist companies in providing their users with useful accounting information. Information is labelled as being useful when it meets the qualitative characteristics set out by the International Accounting Standards Board (IASB). The IASB is responsible for “ the development and endorsement of International Financial Reporting Standards (IFRSs)” (IFRS, 2011). The qualitative characteristics consist of both fundamental and enhancing features. This paper will focus on the main characteristics which are: relevance, faithful representation, comparability and the ability to understand the information, and will be applying these to the techniques used to reliably measure tangible non-current assets. In order to reliably measure these assets it is essential to be consistent with the measurement technique chosen. At a recent conference Hans Hoogervorst, the chairman of the IASB, admitted that he was “ struck by the multitude of measurement techniques” and realises that measurement is a “ thorny issue” which needs tackling (Hoogervorst, 2012).

Indeed, when it comes to techniques there is: historic cost, fair value, realisable value, value in use and many more. In response to this plethora of measurement techniques it is clear to understand why Hans Hoogervorst believes that “ accounting standard-setters come under so much pressure” (Hoogervorst, 2012). Considering this stems the first issue concerning multiple measurement techniques – comparability. As soon as more than one option is provided and choice is open to organisations, comparability is lost

as you cannot usefully compare the two business' non-current asset values. In addition to this, the multitude of techniques also introduces a problem of conflict; a ' trade-off' in the dominant characteristic. Information which is relevant may not be reliable and vice versa; yet both need to be considered in order to label information as being useful. To faithfully represent a transaction indicates reliability; hard evidence that this is the reality. However, reliability often conveys a sense of the information being out of date – especially when taking a historic cost approach – and therefore lacks relevance.

A relevant example of this would be the figure representing a vehicle in the Statement of Financial Position (also, balance sheet). A reliable figure would be what was paid for the vehicle; proof of this can be provided in the form of an invoice or receipt. Relevance however is now somewhat lacking due to this information not portraying the true value of this vehicle a year on at the date of the annual reports being published. The definition of a tangible non-current asset under the relevant standard – IAS 16 ' Property, Plant and Equipment'– is: “ a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”, which has physical substance and “ can be measured reliably” (IAS Plus, 2012). However, as already discussed, measuring reliably is not an easy task. Consider the historical cost approach in more detail; a backward looking view is adopted. When measuring tangible non-current assets with this approach, a useful life is calculated. This useful life however is only an estimate, a subjective approach to measure how long an asset will be producing economic benefits for. Also, avoiding material error with this

estimate is crucial. As an example, a company owns a factory which manufactures a new one of a kind technological device.

With the product it produces and the machine itself being so unique it would be very difficult to reliably measure how long this will last. Even conveying this scenario to independent industry experts would not result in anything more than judgment and estimates due to its distinctiveness. This is one key problem area with IFRSs; it is principles based which means that rather than following a solid set of rules, accountants use their own judgment.

Furthermore, by adopting a historical cost approach the assets will be depreciated over that useful life which has been estimated. With the useful life of an asset being so subjective it is hard to apportion a useful figure to depreciation. By increasing the useful life of an asset you are effectively spreading the depreciation expense over a longer period of time resulting in lower depreciation expenses and vice versa. In fact, Zheng et al. (2012) go one step further and consider depreciation to be a strategy for managers to manipulate profits. In addition to affecting profits by adjusting useful life and depreciation; key ratios will also be affected. The net profit margin can be influenced both ways to fit the purpose of business strategy.

It could be increased to make it seem more profitable, or it can be influenced in a negative way to write off as much expenses as possible – if the year held disappointing results – in order to show next year more positively in comparison. Return on non-current assets can also be exaggerated with this level of manipulation; as lower depreciation will keep extra value in the figure listed in the balance sheet. This leads to the statements not being faithfully represented and therefore not useful. Consequently, this will lead <https://assignbuster.com/measurement-of-tangible-non-current-assets-essay-sample/>

to the analysis of investors being misguided. Investors require financial information to be useful for economic decision making reasons. They need to know whether they are presented with a good opportunity to buy into a company, hold on to shares previously bought or even sell their shares. Although investors are absolutely not the only other user of financial information, the Revised Statement of Principles (2010) states that they are the predominant user and so take precedence (Elliott & Elliott, 2012). Tangible non-current assets can also be affected by impairments using a costing method. Impairments occur when an asset is valued lower than its carrying amount in the balance sheet. Value approaches rely more on impairments as they are not depreciated.

Fair value is more of a forward looking approach; a market view. Rather than involving stewardship by looking back and communicating to shareholders how you have taken care of the company's assets, you are looking to the future to show how they will be used to generate future revenues. As mentioned, using a fair value approach does not require you to depreciate your assets however it does require you to check for impairments. IAS 16 [IAS 16. 77] declares that items such as the date of revaluation, methods and assumptions used in estimating the new value and whether or not an independent valuer was involved should be disclosed in the notes to the statements (IAS Plus, 2012). The last point mentioned above – whether or not an independent valuer was involved – is of extreme interest. This indicates that the standard does not actually require an independent valuer to be present. This introduces an opportunity for an extreme amount of bias. An internal manager, or other employee with the authority, could value it at

the carrying value or higher in order to remove the possibility of the asset being impaired. This would result in an absence of relevance and therefore the information would no longer be useful. Although this strategy may be beneficial in the short-term, in the long-term this raises a level of uncertainty regarding volatility of profits.

Depending on the policies put in place, a heavy loss due to impairment can occur at any time. An example of this would be the recent unfolding of HP's \$8.8b impairment charge associated to the "serious accounting improprieties, misrepresentation and disclosure failures" of Autonomy's management before their acquisition by HP (HP, 2012). With such a strong statement the question should have been asked as to whether the accounts of Autonomy were truly understandable at the time of acquisition. If HP were willing to pay such huge sums of money they surely should have some indication as to how they are valued so highly. Whereas costing methods are focused more on reliability, value methods are focused more on relevance as is clear by how they are approached. Nevertheless, both relevance and reliability have to be considered in order for information to be useful. In Bricker and Chandar's findings (2012), they establish that the market still values both relevance and reliability stating that a combination of relevance and reliability results in "higher overall decision usefulness".

When considering that certain companies hold a lot of value on their balance sheets in the form of tangible non-current assets, the more information is useful, the better. In order to further evaluate whether IFRSs provide useful information on the measurement of tangible non-current assets, this essay will now introduce two FTSE 100 company examples. Whitbread plc. is the <https://assignbuster.com/measurement-of-tangible-non-current-assets-essay-sample/>

first example. Within Whitbread's balance sheet it is visible that 87% of total assets are made up of tangible non-current assets. These are valued using a historical cost approach. With regards to the comments on impairment made previously, it is interesting to see that no independent valuations are required for impairment tests on assets. Using this method presents bias and regarding Bricker and Chandar's findings, investors could see reliability lacking. In fact, continuing through to Whitbread's notes on impairments shows that the previous year's impairments have almost been removed totally through impairment reversals. Although the relevant standard – IAS 16 – allows the reversals of impairments, it seems illogical.

The impairment of a non-current asset could materially affect the financial statements by reducing profitability and affecting key ratios. This could affect the decision making process of investors adversely, when in fact within another twelve months there would be evidence that the assets should not have been impaired to begin with. It is also difficult to see how cost generating units (CGUs) in Whitbread would be worth nothing after writing off expenses in the form of depreciation and impairments considering the heavy brand quality carried on these buildings. Whitbread also state that they consider the market value of their assets using an accepted industry valuation methodology. This sounds authentic, but there is no detail into which methodology is used. This again highlights the issues of having IFRSs which are based on principles. Accountants get to judge which method is best to use and so when comparing similar tangible non-current assets to those of Whitbread, you are not necessarily receiving a useful comparison.

In order to highlight the points made in this essay, my second FTSE 100 company example is Marks & Spencer (M&S) who also have a large proportion of tangible non-current assets on their balance sheet and also use a historic cost approach. Out of their total assets 70% of them are tangible non-current assets. Unlike Whitbread, M&S list their impairments separately beneath profits before tax. This seems to be more useful as it is understandable where these figures originated. However, M&S state in their annual report that adjustments made are to exclude profits and losses on the disposal of properties. With properties being a tangible non-current asset of which their balance sheet seems to be dominated by, it does not seem useful to not indicate the proportion of disposals made up by properties. It is not required by IFRSs to disclose this however, this would be useful information. They later declare that the methods they use to determine profits, which the expense write-offs of tangible non-current assets contribute to, are not a recognised measure under IFRS and so are not directly comparable with measures used by other companies.

By not complying with IFRSs they are directly affecting their comparability and are actually declaring that lack of useful information in their annual report. In conclusion, with principles being the approach taken in IFRSs it is unclear as to whether information will ever be useful considering the lack of comparability using this approach provides. The two company examples used both had a large portion of tangible non-current assets, and to be able to exercise judgment on policies affecting the measurement of these is a colossal responsibility. IFRSs are not set in stone and are amended regularly. With such a strong stakeholder focus on these characteristics and with the



chairman of the IASB himself in shock of the issues of measurement, future amendments ought to slowly bridge the gap between unsure measurement techniques and usefulness.

## References

Bricker, R. & Chandar, N. (2012) Relevance, reliability and restricted security fair values: a look at investment trusts, *Managerial Finance* July 2012, Vol. 38 Iss: 12 pp. 1203 – 1225

Elliott, B. & Elliott, J. (2012) *Financial Accounting and Reporting* Page 247-248, Fifteenth Ed. FT: Prentice Hall

Hoogervorst, H. (2012) 'The imprecise world of accounting' Proceedings of the International Association for Accounting Education & Research (IAAER) Conference Amsterdam. 20th June, 2012.

HP (2012) HP Issues statement regarding Autonomy impairment charge Available: <http://www.hp.com/hpinfo/newsroom/press/2012/121120b.html> [Accessed: 23rd November, 2012]

IAS Plus (2012) IAS 16 'Property, Plant and Equipment' Available: <http://www.iasplus.com/en/standards/standard14> [Accessed: 12th November, 2012]

IFRS (2011) IASB and IFAC to enhance co-operation in developing private and public sector accounting standards Available: <http://www.ifrs.org/Alerts/PressRelease/Pages/IASB-IFAC-MOU-Nov-2011.aspx> [Accessed: 30th October, 2012]

<https://assignbuster.com/measurement-of-tangible-non-current-assets-essay-sample/>

Marks & Spencer (2012) Annual Report and Accounts

Available: [http://annualreport.marksandspencer.com/\\_assets/downloads/Marks-and-Spencer-Annual-report-and-financial-statements-2012.pdf](http://annualreport.marksandspencer.com/_assets/downloads/Marks-and-Spencer-Annual-report-and-financial-statements-2012.pdf) [Accessed: 25th November, 2012]

Whitbread plc. (2012) Annual Report and Accounts

Available: [www.whitbread.co.uk/content/dam/whitbread/siteimages/investors/results-reports/annual-report-2011-12.pdf](http://www.whitbread.co.uk/content/dam/whitbread/siteimages/investors/results-reports/annual-report-2011-12.pdf) [Accessed: 23rd November, 2012]

[uk/content/dam/whitbread/siteimages/investors/results-reports/annual-report-2011-12.pdf](http://www.whitbread.co.uk/content/dam/whitbread/siteimages/investors/results-reports/annual-report-2011-12.pdf) [Accessed: 23rd November, 2012]

Zheng, X., Guo, Y, & Xu, J. (2012) The influence of depreciation policies on financial statement analysis: A case study of airline industry 7th International Scientific Conference, “ Business and Management” May 10-11, 2012, page 269-270