Property, plant and equipment

Studying this technical article and answering the related questions can count towards your verifiable CPD if you are following the unit route to CPD and the content is relevant to your learning and development needs. One hour of learning equates to one hour of CPD. We'd suggest that you use this as a guide when allocating yourself CPD units. Property plant and equipment (PPE) are tangible assets that an entity holds for its own use or for rental to others, and that the entity expects to use during more than one period. PPE could be constructed by the reporting entity or purchased from other entities.

Biological assets, intangible assets and investment property are not PPE. Neither are investments in subsidiaries, associates and joint ventures. The recognition and measurement of exploration and evaluation assets is set out in IFRS 6, Exploration for and Evaluation of Mineral Resources. Mineral rights and exploration and evaluation assets are specifically excluded from the scope of PPE. However, productive assets held by entities in the extractive industries are subject to the same recognition and measurement rules as other PPE. Recognition

An item of PPE should be recognised as an asset, if it is probable that future economic benefits associated with the asset will flow to the entity and the cost of the item can be measured reliably. Future economic benefits occur when the risks and rewards of the asset's ownership have passed to the entity. PPE is initially recognised at its cost, which is the fair value of the consideration given. All the directly attributable costs necessary to bring the asset into working condition should be capitalised: these costs include delivery and installation costs, architects' fees and import duties.

Where relevant, these costs should include borrowing costs and directly attributable overhead costs. Any income earned during the pre-production phase, which is not necessary to bring the asset into working condition, should be recognised in the income statement. The cost might also include transfers from equity of gains/losses on qualifying cashflow hedges that are directly related to the acquisition of property, plant and equipment. Where consideration is deferred beyond normal credit terms, it should be discounted to present value.

After initial recognition, the asset should be measured at cost less accumulated depreciation and impairment losses or at a revalued amount, which is its fair value less subsequent depreciation and impairment losses. In this case, fair value must be reliably measurable. Revaluations must be made with sufficient regularity to ensure that the carrying amount is not materially different from fair value. However, if an asset is revalued, then the entire class of asset must be revalued. The fair value of property is its market value. A professionally qualified valuer normally undertakes the valuation.

IAS 16 does not use the value to the business model. As a consequence, IAS 16 is not prescriptive in requiring such things as non-specialised properties to be valued at existing use value (EUV), at depreciated replacement cost and properties surplus to requirements to be valued at open market value. Disclosure should be made whether the revaluation was performed by an independent valuer or not. The same rule for revaluation of property applies to plant and equipment. However, there are difficulties of obtaining a market value for plant and equipment that are recognised in IAS 16.

Valuation at depreciated replacement cost is allowed when there is no real market value, because of the specialised nature of the assets. If a revaluation results in an increase in value it should be credited to equity, 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 as income. 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 the income statement so as to prevent ‘ recycling’. IAS 16 capitalises subsequent expenditure on an asset using the same criteria as the initial spend; that is, when it is probable that the future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.

If part of an asset is replaced, then the part it replaces is derecognised, regardless of whether it has been depreciated separately or not. This is in contrast to certain local generally accepted accounting principles (for example, UK GAAP), which require capitalisation of subsequent expenditure only when the expenditure improves the condition of the asset beyond its previously assessed standard of performance. Depreciation The depreciable amount (cost less prior depreciation, impairment and 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 residual value of an item of PPE is based on the estimated amount that an entity would currently obtain from the asset's disposal, less estimated selling costs, if the asset were already of the age and in the condition expected at the end of its useful life. Thus, residual values take account of changes in prices up to the balance sheet date, but not of expected future changes.

Residual values are not based on prices prevailing at the date of acquisition (or revaluation) of an asset, but take account of subsequent price changes. Depreciation commences when an asset is in the location and condition that enables it to be used in the manner intended by management. Depreciation ceases at the earlier of its derecognition (sale or scrapping) or its reclassification as ' held for sale' and should be reviewed at least at each year end. Temporary idle activity does not preclude depreciating the asset, as future economic benefits are consumed not only through usage but also through wear and tear and obsolescence.

IAS 16 does not include any reference to renewals accounting and, therefore, does not allow any departure from the principle that the depreciation expense is determined by reference to an asset's depreciable amount. Derecognition PPE is derecognised on disposal or when no future economic benefit is expected from its use or disposal. Gains on disposal should not be classified in the income statement as revenue. When an entity purchases or

constructs an asset, it may take on a contractual or statutory obligation to decommission the asset or restore the asset site.

These costs should be capitalised at the date on which the entity becomes obligated to incur them. The amount capitalised as part of the asset's cost will be the amount estimated to be paid, discounted to the date of initial recognition. The related credit is recognised in provisions. There may be significant changes in the initial (and subsequent) estimates of decommissioning costs of an asset, particularly where asset lives are long. These changes in estimate may be because of changes in legislation, technology and timing of the decommissioning and or management's assumptions.

An entity that uses the cost model records changes in the existing liability and changes in the discount rate, adjusting the cost of the related asset in the current period. An entity using the revaluation model accounts for changes effectively through the revaluation reserve. Impairment Impairments should be accounted for in accordance with IAS 36, Impairment of Assets. An impairment loss under the revaluation model is treated as a revaluation decrease to the extent of previous revaluation surpluses. Any loss that takes the asset below historical depreciated cost is recognised in the income statement.

Where there is a reversal of an impairment loss, the amount of the reversal that can be recognised is restricted to increasing the carrying value of the asset to the carrying value that would have been recognised had the original impairment not occurred. In other words, after taking account of normal

depreciation that would have been charged had no impairment occurred. Compensation may be received in the form of reimbursements and is recorded in the income statement when the compensation becomes receivable.

Impairment indicators are more likely to be prevalent at the present time, therefore requiring assets to be evaluated for impairment. Owing to the current economic environment, it may be more likely that impairment indicators exist. Impairment must be considered at both interim and annual reporting dates. Recoverability When PPE is tested for recoverability, it might also be necessary to review depreciation and amortisation estimates and methods. The manufacturing sector is likely to be severely affected. For instance, there could be cancelled sales orders.

This would cause some of the PPE to become idle and the utilisation rate of the machinery is likely to drop. As a result of the lower utilisation rate, there is an implication for the impairment of plant, given that the plant will be idle and not be involved in generating cashflows to the entity. Non-cash generating units are an indication of impairment, as the return on assets in this situation is significantly reduced. Graham Holt, ACCA examiner and principal lecturer in accounting and finance, Manchester Metropolitan University Business School.