



FINANCIAL REPORTING

*IAS 16: PROPERTY, PLANT &
EQUIPMENT*

PPE DEFINED

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 during more than one period.

OBJECTIVE OF THE STANDARD

The objective of this Standard is to prescribe the accounting treatment for PPE so that users of the financial statements can determine information about an entity's investment in its PPE and the changes in such investment.

The key issues here shall include:

- Recognition of PPE.
- Determination of the carrying values of PPE.
- Computation of depreciation and impairment losses relating to PPE.

SCOPE OF THE STANDARD

The standard does not apply to;

- Property, plant and equipment classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.
- Biological assets related to agricultural activity other than bearer plants in accordance with IAS 41 Agriculture. The Standard applies to bearer plants but it does not apply to the produce on bearer plants.
- Recognition and measurement of exploration and evaluation assets in accordance with IFRS 6 Exploration for and Evaluation of Mineral Resources.
- mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

RECOGNITION

An item of property, plant and equipment should be recognized as an asset when:

- it is probable that future economic benefits associated with the asset will flow to the entity;
and,
- the cost of the asset can be measured reliably.

INITIAL MEASUREMENT

- An item of property, plant and equipment should initially be measured at its **cost**.
- This will include all costs involved in bringing the asset into working condition such as; the cost of site preparation, delivery costs, installation costs, borrowing costs in accordance to IAS 23, dismantling costs.
- The present value of dismantling costs should be capitalized, with an equivalent liability recognized. (the discounted liability would then be unwound over the period until the dismantling costs are paid.)
- Unwinding will cause a liability to grow with the increment being finance costs debited to the SOPL each year.

ILLUSTRATION

Consider a building that has been constructed at a cost of Shs 500 million that would require removal after 10 years at a cost of Shs 25 million. Show extracts of financial statements regarding the asset considering an interest rate of 10%.

ELEMENTS OF COST

Cost of PPE shall comprise of the following;

- Purchase price (after deducting trade discounts and rebates) including import duties and non-refundable purchase taxes.
- 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 which include the following.
 - Costs of site preparation
 - Initial delivery and handling costs
 - Installation and assembly costs
 - Costs of testing
 - Professional fees
 - costs of employee benefits (as defined in IAS 19 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment.

SUBSEQUENT EXPENDITURE

Subsequent expenditure on property, plant and equipment should only be capitalized if:

- It enhances the economic benefits provided by the asset. This could be thru extending the asset's life, an expansion or increase in the productivity of the asset.
- It relates to an overhaul or required major inspection of the asset. In that case, the costs associated with this should be capitalized and depreciated over the time until the next overhaul or safety inspection.
- It is replacing a component of a complex asset in which case the replaced component shall be derecognized.

NB: A complex asset is an asset mad up of a number of components with each component depreciated at different rates.

All other subsequent expenditure should be expensed in the SOPL as revenue expenditures. (they maintain economic benefit originally expected)

SUBSEQUENT MEASUREMENT

After recognition, an entity shall choose either the **cost model** or the **revaluation model** as its accounting policies to measure PPE. The entity shall apply the chosen accounting policy to its entire class of PPE.

The cost model:

Property, plant and equipment should be valued at cost less accumulated depreciation and any accumulated impairment losses.

The revaluation model:

PPE may be carried at a revalued amount less any subsequent accumulated depreciation and subsequent impairment losses.

If the revaluation model is chosen, the following must be complied with;

- Revaluations must subsequently be made with sufficient regularity to ensure that the carrying amount does not differ materially from the fair value at each reporting date. (The frequency of revaluations depends upon the changes in fair values of the items of PPE being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of PPE experience significant and volatile changes in fair value, thus necessitating annual revaluation).
- When an item of PPE is revalued, the entire class of assets to which the item belongs must be revalued.

ACCOUNTING FOR REVALUATIONS

Steps taken after revaluation has occurred;

- Restate asset's cost to the new revalued amount.
- Eliminate any existing accumulated depreciation for the asset.
- Show the total increase in OCI which would then be accumulated to equity under revaluation surplus.

If revaluation results into a gain;

The gain is recorded as a component of other comprehensive income either within the SOPL&OCI or in a separate statement. This gain is then carried in a revaluation surplus within equity. This revaluation surplus is a capital reserve and is therefore not permitted to be distributed to the shareholders. (Dec 2022 qn. 1 (1))

If revaluation results into a loss;

The loss represents an impairment of the asset value and therefore recognized in the SOPL. However, when a revaluation loss arises on a previously revalued asset it should be deducted first against the previous revaluation gain and can therefore be taken to OCI in the year. Any excess impairment will then be recorded as an impairment expense in the SOPL. (MAR 2022 QN. 1 (1))

JOURNAL ENTRIES

Upon an increase in value;

Dr. Property, plant and equipment (with the revalued amount less cost)

Dr. Acc Depreciation (to eliminate it)

Cr. OCI (with the revaluation surplus)

Upon a decrease in value;

Dr. Profit or loss (with the loss on revaluation)

Dr. Accumulated depreciation (to eliminate it)

Cr. Property, plant and equipment (with the revalued amount less cost)

ILLUSTRATION

Consider the following entity's statement of financial position extracts as at 31/12/2021

Shs. 000

Buildings

Cost	150,000
Acc Depreciation	40,000
Carrying Amount	110,000

If the building is revalued on 01/01/2022 to Shs. 160,000,000 and its remaining useful life is estimated to be 20 years at the date of revaluation.

Required:

To show the extracts of the financial statements of the entity for the year ending 31/12/2022

DEPRECIATION OF REVALUED PPE

After an item of PPE has been revalued, the following is required;

- Depreciation must be charged (Revalued amt less residual value over remaining useful life) and recognized in the SOPL.
- An annual reserves transfer **may** be made, from revaluation surplus to retained earnings, for the additional depreciation charged on the revalued amount compared to cost (to address the imbalance between a non-distributable gain held in revaluation surplus and the reduction in retained earnings due to the increased depreciation charge). This is done in SOCE.

Journal entries in case of transfer;

DR Revaluation surplus (with Dep on valued amt less Dep on original cost)

CR Retained earnings

DISPOSAL OF REVALUED ASSETS

After computing the gain or loss on disposal of an item of PPE, the following shall be done;

- The resultant gain or loss shall be recognized in the SOPL of the period in which the disposal occurs.
- Any balance on the revaluation surplus relating to this asset should be transferred to retained earnings.

DISCLOSURES

For each class of Property, plant and equipment, management shall disclose in the financial statements;

- The measurement bases used for determining the gross carrying amount
- The depreciation methods used
- The useful lives or the depreciation rates used
- the gross carrying amount and the accumulated depreciation at the beginning and end of the period
- the amount of expenditures recognized in the carrying amount of an item of property, plant and equipment in the course of its construction
- the amount of contractual commitments for the acquisition of property, plant and equipment