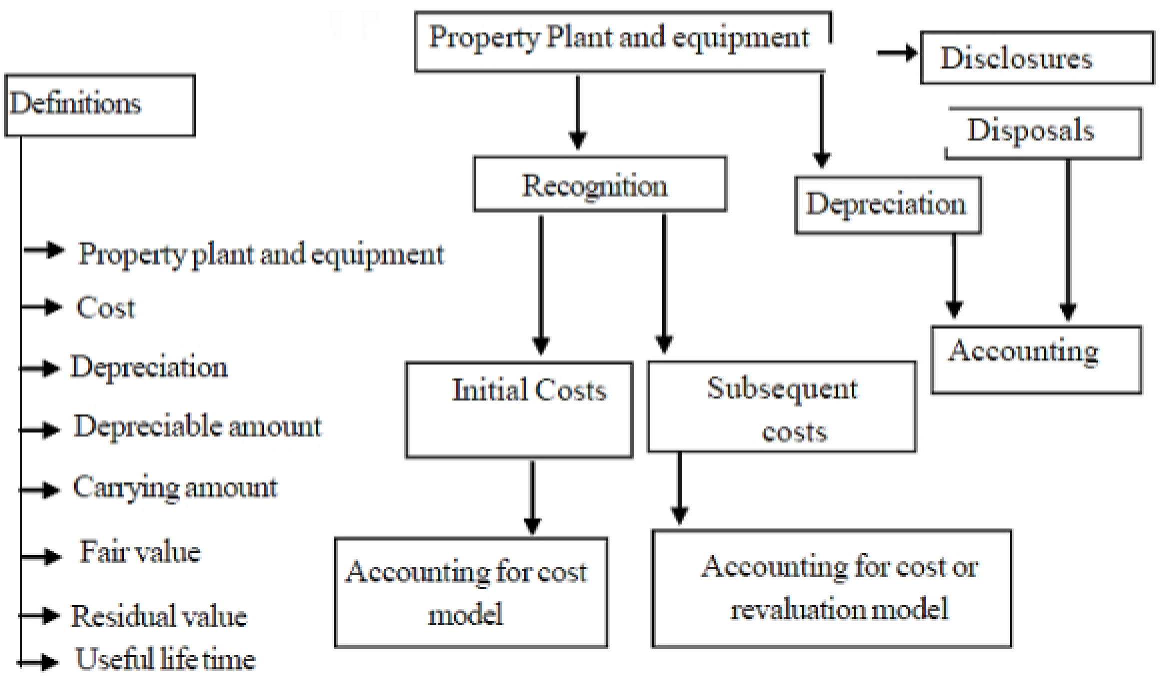
11.5 | Property, Plant and Equipment (PPE)

- **Definition for PPE and related terms**
- **Initial costs and subsequent costs**
- **Elements of costs**
- **Measurement at recognition and revaluation**
- **Depreciation methods and accounting**
- **Disposal of PPE**
- **Disclosures regarding PPE**

Concept map



Property, plant and equipment

- 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.

Cost

- Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements.

Depreciation

- Depreciable amount is the cost of an asset or other amount substituted for cost, less its residual value.

Carrying amount

- Carrying amount is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairments losses.

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Fair value

- Fair value is the amount for which an asset could be exchanged between knowledgeable and willing parties in an arm's length transaction.

- Arm's length transaction: It refers to a business transaction in which the buyers and sellers act independently without one party influencing another (in their own self-interest and are not subject to pressure or collusion, with equal access to information)

Residual value

- The 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, in the condition expected at the end of its useful life.

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.

Recognition

The cost of an item of property, plant and equipment shall be recognized as an asset if,

1. It is probable that future economic benefits associated with the item will flow to the entity
2. Cost of the item can be measured reliably

Types of costs

An entity evaluates under the recognition principle all its property plant and equipment costs at the time they are incurred. These costs can be of two types:

1. Initial costs
2. Subsequent costs

Initial costs

- Costs incurred initially to acquire or construct an item of property, plant and equipment. These costs should be capitalized.

Subsequent costs

Costs incurred subsequently to add to, replace part of, or service it. Could be identified in two types:

1. Capital expenditure
2. Revenue expenditure

Capital expenditure

Expenditure incurred in an innovation or establishment of a new equipment to increase the useful life time of an asset or capacity of an asset or quality of the products or to decrease expenses related in production could be identified as capital nature expenses.

- Purchase of machinery
- Expansion of factory

Revenue expenditure

The costs incurred in maintaining the assets.

- Machine repair expenses
- Building painting expenses

PPE measurement at initial recognition
An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost and it includes following: a) Its purchase price, including import duties and non refundable purchase taxes, shipment charges, and insurance charges, after deducting trade discounts and rebates. b) Any costs directly attributable to bringing the asset to the expected location and condtion. c) The estimation of costs of dismantling and removing the assets at the end of the lifetime.
Examples: o Direct costs of construction or acquisition of assets o Cost of site preparation o Initial delivery and handling costs o Installation and assembly costs o Net costs of testing whether the asset is functioning properly o Professional fees

PPE measurement at subsequent recognition
• After initial recognition of PPE, an entity has to choose one of the following methods for subsequent measurement: o Cost model o Revaluation model • In the <u>cost model</u>, the asset is carried at its cost minus accumulated depreciation. • In the <u>revaluation model</u>, the asset is carried at its fair value at the revaluation date minus accumulated depreciation. o Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the end of the reporting period. o Frequency of revluations depend upon the changes in fair values being revalued. If it differs materially, then a revaluation is required. o For items that experience significant and volatile changes in fair value, annual revaluations are necessary. o For items that have only insignificant changes in fair value, it may be necessary to revalue the item only every three or five years. o The same measurement model should be applied to an entire class of PPE (examples of separate classes include land, land & buildings, machinery, motor vehicles, furniture, office equipment, etc).

Revaluation model
• If an asset's carrying amount is increased as a result of revaluation, the increase shall be recognized in other comprehensive income and accumulated in equity under the heading of "revaluation surplus". o However, the increase shall be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss. • If an asset's carrying amount is decreased as a result of revaluation, the decrease shall be recognized in profit or loss. o However, the decrease shall be recognized in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. o The decrease recognized in other comprehensive income reduces the amount accumulated in equity under revaluation surplus.