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BUS 320

Intermediate Accounting

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Lecture 10 Long-Lived Asset

Capitlization

- Capitalized cost of property, plant, and equipment includes all expenditures needed to:

  Acquire the asset (purchase price, net of discounts and rebates)

  Bring it to its location and to a state where it is ready for use (including delivery, site preparation, installation, assembly, professional fees, etc.)

  Discharge obligations associated with asset's eventual disposal (e.g., site restoration)

  The cost of self-constructed assets includes:
  - Direct materials,
  - Direct labour,
  - Directly attributable overhead (e.g., variable manufacturing overhead)

  Under I F R S, borrowing costs to finance the cost of acquiring, constructing or producing assets that take a substantial period of time to get ready and that would otherwise be avoidable, are to be capitalized

Let's look at IAS 16

Property, Plant and Equipment

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Property, plant and equipment **are tangible items that:**

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

Let's also look at IAS 40

Investment Property

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Investment property **is property (land or a building - or part of a building - or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:**

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

… so, what about a property that is generating rental income?

Is it PP&E? or

Is it Investment Property?

Asset Retirement Obligation

Asset Retirement Obligation – IFRS

Costs of dismantling and removing the asset and restoring the site on which the asset is located, i.e., asset retirement costs
- costs related to the "acquisition" (and not the "use") of the asset
- applicable to an asset used for purposes other than to produce inventories

Relevant standard is IAS 16 PP&E

Legal or constructive obligation to restore assets when an asset (or group of assets) is retired at a future date

Equipment (B/S)	700,000	
Cash (B/S) (price paid for equipment)		500,000
Asset Retirement Obligation (B/S)		200,000*

IAS 16, para.16(c): The cost of PP&E comprises … 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.

* Assume estimated future cash flow $1,345,500 required in 20 years, discounted at 10%, liability at present value = $200,000

Interest expense will be accrued and charged annually over the next 20 years; liability balance will increase every year by the amount of interest accrued; the general idea is that eventually the liability will reach $1,345,500 at the end of the 20-year period.

Asset Retirement Obligation – IFRS (contd.)

- for an item that is used to produce inventories

mentioned in IAS 16 PP&E, BC15; relevant standard is IAS 2 Inventories

each year, recognize a portion of the obligation that is related to the amount of inventory produced in the year

- e.g., assume total number of widgets expected to be produced by the equipment over its entire useful life is 269,100 units, and 32,000 units were produced in YR1
- $1,345,500 x 32,000/269,100 = $160,000, unit-of-production depreciation method

YR1	Inventory (B/S)	160,000	
	Asset Retirement Obligation (B/S)		160,000

IAS 16, BC15: … An entity applies IAS 2 *Inventories* to the costs of these obligations that are incurred as a consequence of having used the item during a particular period to produce inventories during that period

a similar entry is made every year, and the general idea is that by the time all the inventories have been produced, the full amount of the liability would have been recognized

Nonmonetary Exchange

Non-monetary Exchanges - summary

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Commercial substance measured by **extent to which the future cash flows from assets are expected to change** as a result of the exchange transaction

Consider whether
a) configuration (timing, amount, and risk) of cash flows differs between the assets exchanged
b) entity-specific value of the portion of the entity's operation affected by the exchange
c) difference in (a) and (b) is significant relative to fair value of assets exchanged

Non-monetary Exchanges - summary

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APPLY the fair value standard:
- cost of asset(s) received measured at
  - fair value of asset(s) given up, OR
  - at the fair value of asset(s) received if more clearly evident

AND
- any gain or loss recognized in income

UNLESS
- exchange transaction lacks commercial substance, OR
  fair value of neither asset is reliably measurable

If exchange transaction lacks commercial substance, OR
If cannot measure fair value of both assets, must measure the cost of the asset(s) received at the carrying amount of asset(s) given up
- no gain or loss is recognized in income

An overriding caution: The asset(s) received should never be measured at an amount higher than its/their fair value

If fair values of both asset(s) received and asset(s) given up can be reliably measured, then the fair value of asset(s) given up is used to measure the cost of the asset(s) received unless the fair value of asset(s) received is more clearly evident

Measurement after Acquisition - summary

- There are three main measurement methods to account for PP&E and investment property subsequent to acquisition:
  1. Cost Model
  2. Revaluation Model
  3. Fair Value Model
- Under IFRS, companies have the following choices:
  - For investment property assets (IAS40):
    Cost Model or Fair Value Model
  - For PP&E assets (IAS16):
    Cost Model or Revaluation Model
- Under ASPE, Cost Model must be used

Revaluatiion Model

A simple example

1st revaluation

If Asset's carrying value increases $100

- CR Revaluation Surplus (in OCI) $100

2nd revaluation

If asset's carrying value then drops $50

- DR Revaluation Surplus (OCI) for $50

If ***instead*** the asset's carrying value drops $150

- DR Revaluation Surplus (in OCI) $100, and
- DR Revaluation Loss (I/S) for $50

3rd revaluation

If carrying value later increases $100

- CR Revaluation Recovery of Loss (I/S) $50, and recovery
- CR Revaluation Surplus (OCI) for $50

this is done on an asset-by-asset basis; therefore, need to keep track of Revaluation Surplus and Revaluation Loss for each individual asset

Proportionate approach	Asset Adjustment method
• Adjusts the asset's carry amount and its accumulated depreciation	Eliminates the balance in the Accumulated Depreciation account, writing it off against the asset
• Net balance is the fair value of the asset on the revaluation date	The asset is then adjusted to its revalued amount
• Gives some idea of the age of the asset because the accumulated depreciation continues	Simpler method
• Example shown in Appendix 10B	Also called the elimination method

Fair Value Model

- Investment property measured at fair value subsequent to acquisition and until it is disposed of
- Changes in value reported in net income during period of change
- No depreciation is recognized over asset's life

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