



IFRS[®]
Accounting

Educational Module 17
Property, Plant and Equipment

IFRS for SMEs[®]

Accounting Standard
Third Edition



International Accounting Standards Board

IFRS[®] Foundation
Supporting Material for the
***IFRS for SMEs[®]* Accounting Standard**

including the full text of
Section 17 *Property, Plant and Equipment* of the
IFRS for SMEs Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 17 *Property, Plant and Equipment* of the *IFRS for SMEs* Accounting Standard are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs* Accounting Standard contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 17.

This module has been prepared by the International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs* Accounting Standard and have not been approved by the IASB.

INTRODUCTION

What is the *IFRS for SMEs* Accounting Standard?

The *IFRS for SMEs* Accounting Standard (Standard) is intended for use by entities that publish general purpose financial statements and that do not have public accountability (referred to as small and medium-sized entities—see Section 1 *Small and Medium-sized Entities*).

The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

What does this module cover?

This educational module supports the requirements for accounting for and reporting of property, plant and equipment in accordance with Section 17 *Property, Plant and Equipment* of the Standard. The module:

- provides explanations and examples to improve understanding of the requirements in Section 17;
- identifies the significant judgements required in accounting for property, plant and equipment;
- includes questions designed to test your understanding of the requirements in Section 17; and
- includes case studies that provide a practical opportunity to apply the Section 17 requirements.

After completing the module, you should be able:

- to distinguish items of property, plant and equipment from other assets of an entity;
- to identify when items of property, plant and equipment qualify for recognition in financial statements;
- to measure items of property, plant and equipment on initial recognition and subsequently, under both the cost model and the revaluation model;
- to present and disclose property, plant and equipment in financial statements;

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- to identify when an item of property, plant and equipment is to be derecognised or transferred to another classification of asset, and account for that derecognition or transfer; and
 - to demonstrate an understanding of the significant judgements that are required in accounting for property, plant and equipment.

Which version of the Standard does the module refer to?

Any reference in this module to ‘the *IFRS for SMEs* Accounting Standard’ is to the third edition of the Standard, issued in February 2025.

What is in the requirements?

The objective of Section 17 is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can assess information about an entity’s investments in property, plant and equipment and the changes in such investments. The main issues that arise are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to these assets.

Section 17 requires an entity to account for property, plant and equipment at its cost at initial recognition and subsequently using either the cost model or the revaluation model (see paragraph 17.15).

For items of property, plant and equipment measured using the revaluation model, revaluations have to be made with sufficient regularity to ensure that the carrying amount does not differ materially from the asset’s fair value at the end of the reporting period.

An item of property, plant and equipment is depreciated over its useful life. The depreciable amount takes into account the residual value of the asset. The residual value, depreciation method and depreciation rate are reviewed if there is an indication of a significant change in expectations since the last annual reporting date. Furthermore, at each reporting date, an entity assesses whether there is any indication that any item of property, plant and equipment may be impaired (that is, whether the carrying amount exceeds the recoverable amount). If any such indication exists, that item of property, plant and equipment is tested for impairment.

When an item of property, plant and equipment is disposed of, the gain or loss on disposal is recognised in profit or loss.

What has changed in the third edition of the Standard?

The IASB changed Section 17 in the third edition of the Standard by:

- amending the scope of the section to include bearer plants that are separately measurable without undue cost or effort (see paragraph 17.3(a));
- clarifying the factors considered in determining the useful life of an asset, stating that expected future reductions in the selling price of an item produced using the asset could indicate the expectation of technical or commercial obsolescence of that asset (see paragraph 17.21(c)); and
- clarifying that a depreciation method based on revenue is not appropriate (see paragraph 17.22).

In addition, this module includes consequential amendments arising from the revised Section 23 *Revenue from Contracts with Customers* and no longer includes disclosure requirements about fair value measurements that are now included in Section 12 *Fair Value Measurement*.

REQUIREMENTS AND EXAMPLES

Scope of this section

- 17.1 This section applies to accounting for **property, plant and equipment** and accounting for **investment property** whose **fair value** cannot be measured reliably without undue cost or effort on an ongoing basis. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.
- 17.2 Property, plant and equipment are tangible **assets** 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.

Educational notes

The Standard does not specify how to classify land held for an undetermined purpose. In developing its accounting policy for land acquired for an undetermined purpose, an entity is permitted, but not required, to look to the requirements of full IFRS Accounting Standards (see paragraph 10.6). IAS 40 *Investment Property* specifies that land acquired for an undetermined purpose is classified as investment property (see paragraph 8(b) of IAS 40) because a subsequent decision to use such land as inventory or for development as owner-occupied property would be an investment decision (see paragraph B67(b)(ii) of the Basis for Conclusions on IAS 40).

Property, plant and equipment excludes assets held for sale in the ordinary course of business, assets in the process of production for such sale, and assets in the form of materials or supplies to be consumed in the production process or in the rendering of services. Such assets are inventories (see Section 13 *Inventories*).

Intangible assets are also not items of property, plant and equipment. They are accounted for applying Section 18 *Intangible Assets other than Goodwill*.

Example—Classification based on use

Ex 1 An SME (parent) holds a building to earn rentals, under an operating lease, from its subsidiary. The subsidiary uses the building as a retail outlet for its products.

In the SME parent's consolidated financial statements (see paragraph 9.2), the building is classified as an item of property, plant and equipment. The consolidated financial statements present the SME parent and its subsidiary as a single economic entity. The consolidated entity uses the building to supply (sell) goods over more than one accounting period.

In the separate financial statements of the SME parent (if prepared; see paragraph 9.24), the building is classified as an investment property (see paragraph 16.2); it is a property held to earn rentals. Consequently, it is accounted for in accordance with Section 16 *Investment Property* unless the fair value of the investment property cannot be measured reliably without undue cost or effort on an ongoing basis. If the fair value cannot be measured reliably, the SME parent accounts for the property applying the requirements of Section 17 (see paragraphs 16.7 and 17.1).

Examples—Items of property, plant and equipment

Ex 2 An SME owns a factory building in which it manufactures its products.

The building is classified as an item of property, plant and equipment. It is a tangible asset used in the production of goods that is expected to be used during more than one reporting period.

Ex 3 An SME owns a building occupied by its administrative staff.

The building is classified as an item of property, plant and equipment. It is a physical asset used for administrative purposes that is expected to be used during more than one reporting period.

Ex 4 An SME that sells equipment to catering businesses owns a fleet of motor vehicles. The vehicles are used by the sales staff in the performance of their duties.

The motor vehicles are classified as items of property, plant and equipment. They are physical assets used in the supply of goods during more than one reporting period.

Ex 5 An SME owns a motor vehicle for the exclusive business and private use of its chief financial officer.

The motor vehicle is classified as an item of property, plant and equipment. It is a physical asset used in the administration of the entity during more than one reporting period.

Ex 6 An SME enters into an agreement under which, for one combined payment, it acquires an existing building and the right to use the land on which the building sits (freehold ownership of land is not possible in that jurisdiction). The building is occupied by the SME's administrative staff. The ongoing annual rental for the land is nominal.

The SME will first need to assess whether the nature of the arrangement is a purchase, a finance lease or an operating lease to determine which section of the Standard to apply, and how. The nature of the arrangement will depend on the SME's facts and circumstances—this is elaborated upon in Section 20 *Leases*. The asset (or assets) will be treated as property, plant and equipment under Section 17 if the SME concludes that the arrangement is a finance lease (with some additional disclosures required by Section 20). If any element is determined to be an operating lease then for that element no asset, other than any prepaid rent, will be recognised.

Ex 7 An SME owns a fleet of motor vehicles. The vehicles are rented out to customers under operating leases.

The motor vehicles would be classified as property, plant and equipment, because they are held for rental to others. In addition, the motor vehicles would be classified as property, plant and equipment instead of investment property, because only land and buildings can be classified as investment property.

17.3 Property, plant and equipment does not include:

- (a) **biological assets** related to **agricultural activity** (see Section 34 *Specialised Activities*). However, this section applies to **bearer plants** that, at initial **recognition**, can be measured, both initially and on an ongoing basis, separately from the produce on them without undue cost or effort. This section applies to such bearer plants but not to the produce on those bearer plants.
- (b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Educational notes

A biological asset is defined in the Glossary as a living animal or plant. Agricultural activity is defined in the Glossary as the management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.

The Standard was amended for the third edition to include bearer plants in the scope of Section 17, which were previously in the scope of Section 34. A bearer plant is held by an entity solely to grow produce over its productive life. After this time, the bearer plants are usually scrapped. Consequently, the only significant future economic benefits from bearer plants arise from selling the agricultural produce that they create. Bearer plants meet the definition of property, plant and equipment. The use of mature bearer plants to produce agricultural produce is similar to the use of machinery to manufacture goods. An entity derives economic benefits from bearer plants and production plants in a similar way, which in turn is unlike the way an entity derives economic benefits from biological assets harvested for sale. The progressive decline in the future earning potential of a bearer plant over its life is also similar to other depreciable assets like plant and machinery.

Examples—Assessing whether items are property, plant and equipment

Ex 8 An SME provides security services and buys trained guard dogs, which are used to support employees in guarding customers' premises.

The guard dogs would be classified as property, plant and equipment. While the guard dogs are biological assets, the entity is not engaged in agricultural activity.

Ex 9 An SME owns a herd of cattle that form the breeding stock of its agricultural activities. The SME also owns a tractor and trailer used to transport feed to the cattle.

Although the cattle meet the definition of property, plant and equipment—they are tangible assets used in the production of calves during more than one accounting period—they are accounted for as biological assets applying paragraph 34.2. They are outside the scope of Section 17 (see paragraph 17.3(a)).

The tractor and trailer are classified as items of property, plant and equipment. They are tangible assets used in the production of goods during more than one reporting period.

Ex 10 An SME acquires a licence to operate a taxi in a major city.

The taxi licence is not an item of property, plant and equipment. It is an intangible asset (see Section 18).

Recognition

- 17.4 An entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:
- (a) it is **probable** that future economic benefits associated with the item will flow to the entity; and
 - (b) the cost of the item can be measured reliably.
- 17.5 Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this section when they meet the definition of property, plant and equipment. Otherwise, such items are classified as **inventory**.

Educational notes

Section 2 *Concepts and Pervasive Principles* defines an asset and explains the concept of recognition, but does not prescribe conditions for recognition. Instead, the conditions for recognition of an item of property, plant and equipment are set out in paragraph 17.4.

Items such as spare parts, stand-by equipment and servicing equipment are recognised as property, plant and equipment when they meet the definition of property, plant and equipment. For example, if such items meet the conditions in paragraph 17.2(a) and are expected to be used during more than one period (see paragraph 17.2(b)), they are classified as property, plant and equipment. If they do not meet this definition they are classified as inventory. An entity also applies materiality judgements in applying its capitalisation policy. An entity might decide not to recognise an item that meets the definition of property, plant and equipment as an asset if treating it as an expense will not have a material effect on its financial statements. Examples of items whose disclosure might not constitute material information include spare parts and tools.

Examples—Spare parts, stand-by equipment and servicing equipment

Ex 11 An SME manufactures chemicals. It services its manufacturing plant which has a useful life of 10 years using specialised servicing equipment that is unique to the servicing requirements of its plant. The useful life of the servicing equipment is five years.

The servicing equipment is classified as property, plant and equipment. The SME expects to use the servicing equipment to enable its continuing production of goods for more than one reporting period and therefore it meets the definition of property, plant and equipment in paragraph 17.2.

Ex 12 An SME manufactures chemicals. It services its manufacturing plant using common tools. The SME has estimated the useful life of the plant as three years and classified it as property, plant and equipment. The SME keeps a small store of tools and the servicing engineers take a new tool whenever they require one. The entity expects each of the tools to be used for less than a year before the engineer replaces them with new ones.

The servicing tools are not items of property, plant and equipment because they are expected to be used for less than a year. They are classified as inventories.

Ex 13 A private hospital that is an SME has installed two identical back-up generators. The first back-up generator provides electricity when the supply from the national grid is interrupted. The second back-up generator will be used in the unlikely event that the first back-up generator fails when the supply from the national grid is interrupted.

Both back-up generators are items of property, plant and equipment. The stand-by equipment is expected to be used in more than one accounting period, albeit irregularly.

17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (for example, the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30 regardless of whether the replaced parts had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, the entity may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life**.

Educational notes

Paragraph 17.6 draws attention to the fact that paragraph 17.16 requires major components of an item of property, plant and equipment to be separated for depreciation purposes if they have different patterns of consumption of economic benefits. This requirement also applies when the fact that a major component has a different pattern of consumption only becomes apparent at a later stage through, for example, the unexpected need to replace a component.

Examples—Replacement parts

Ex 14 An SME that manufactures agricultural chemicals is required to have the protective lining of its chemical processing plant inspected for corrosion at six-month intervals. If an inspection reveals damage to the lining, the SME is required to replace the lining immediately. Experience has shown that linings require replacement, on average, every four years. The SME depreciates linings on a straight-line basis over their estimated four-year useful life to nil residual value. The other parts of the plant are depreciated on the straight-line basis over their estimated 20-year useful life.

During the current reporting period an inspection revealed that a three-year-old lining with a carrying amount of CU100,000 (CU400,000 cost minus CU300,000 accumulated depreciation) was damaged. The lining was immediately replaced at a cost of CU420,000.¹

To recognise the replacement lining the SME recognises the CU420,000 cost as an addition to the carrying amount of the chemical processing plant. The replacement lining will be depreciated evenly over its estimated four-year useful life.

When the old lining is removed, the SME derecognises the lining asset and recognises an expense in profit or loss of CU100,000 for the derecognition of the damaged lining (see paragraph 17.28).

Ex 15 The facts are the same as in Example 14 except that:

- (a) the cost of the replaced lining is unknown at the time of replacement.
- (b) the lining was not depreciated separately because the SME had not expected to have to replace it during the life of the processing plant. The lining was depreciated along with the other parts on the straight-line basis over their estimated 20-year useful life.

To recognise the replacement lining the entity recognises the CU420,000 as an addition to the carrying amount of the chemical processing plant in property, plant and equipment. The new replacement lining will be depreciated over its estimated useful life. In determining the expected useful life, the entity should consider all available information, including whether the need to replace the old lining affects the expected useful life.

When the old lining is replaced, the SME recognises an expense in profit or loss for the derecognition of the damaged lining (see paragraph 17.28). The cost of the damaged lining could be estimated by calculating the book value at the time of the replacement using CU420,000 as the deemed original cost. The book value would be estimated at CU357,000 ($(17 \div 20) \times 420,000$). Consequently, the expense in profit or loss upon derecognition would be CU357,000.

¹ In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

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- 17.7 A condition of continuing to operate an item of property, plant and equipment (for example, a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Example—Inspections that are a condition of operating an asset

- Ex 16** An SME that operates an executive aviation service is required to have its jet aeroplanes inspected for faults by the national aviation authorities every two years. An inspection was made at the scheduled time, halfway through the current annual reporting period, at a cost of CU20,000.

The SME recognises an asset (property, plant and equipment) of CU20,000 for the inspection. The inspection asset is depreciated evenly over its estimated two-year useful life (that is, CU5,000 expense during the current reporting period). The previous inspection asset had been depreciated down to nil by the time of the inspection, and the new inspection asset will be depreciated down to nil by the time of the next inspection. Consequently, there would be no amount remaining to derecognise by the time of the next inspection.

- 17.8 Land and buildings are separable assets and an entity shall account for them separately, even when they are acquired together.

Educational notes

The requirement that land and buildings are accounted for separately is intended to facilitate component depreciation (see paragraph 17.16) and, in particular, to ensure that when assessing residual value, an increase in land value does not obscure the need to depreciate the other element of the land and building, being the buildings.

Measurement at recognition

- 17.9 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

- 17.10 The cost of an item of property, plant and equipment comprises all of the following:
- (a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) 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. These can include the costs of site preparation, initial delivery and handling, installation and assembly and testing of functionality.
 - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, 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.
- 17.11 The following costs are not costs of an item of property, plant and equipment and an entity shall recognise them as an **expense** when they are incurred:
- (a) costs of opening a new facility;
 - (b) costs of introducing a new product or service (including costs of advertising and promotional activities);
 - (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training);
 - (d) administration and other general overhead costs; and
 - (e) **borrowing costs** (see Section 25 *Borrowing Costs*).
- 17.12 The **income** and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in **profit or loss** if those operations are not necessary to bring the item to its intended location and operating condition.

Example—Measurement at initial recognition

Ex 17 On 1 January 20X1 an SME purchased an item of equipment for CU600,000, including CU50,000 refundable purchase taxes. The purchase price was funded by raising a loan of CU605,000. When the SME draws down the loan, it has at the same time to pay CU5,000 in loan-raising fees to the bank. The loan is secured against the equipment.

In January 20X1 the SME incurred costs of CU20,000 in transporting the equipment to the SME's site and CU100,000 in installing the equipment at the site. At the end of the equipment's 10-year useful life the SME is required to dismantle the equipment and restore the building housing the equipment. The present value of the cost of dismantling the equipment and restoring the building is estimated to be CU100,000.

In January 20X1 the SME's engineer incurred the following costs in modifying the equipment so that it can produce the products manufactured by the SME:

- materials, CU55,000;
- labour, CU65,000; and
- depreciation of plant and equipment used to perform the modifications, CU15,000.

In January 20X1 the SME's production staff were trained in how to operate the new item of equipment. Training costs included:

- cost of an expert external instructor, CU7,000; and
- labour, CU3,000.

In February 20X1 the SME's production team tested the equipment and the engineering team made further modifications necessary to get the equipment to function as intended by management. The following costs were incurred in the testing phase:

- materials, net of CU3,000 recovered from the sale of the scrapped output (CU21,000); and
- labour, CU16,000.

The equipment was ready for use on 1 March 20X1. However, because of low initial order levels the SME incurred a loss of CU23,000 on operating the equipment during March. Thereafter the equipment operated profitably.

What is the cost of the equipment at initial recognition?

<i>Description</i>	<i>Calculation or reason</i>	<i>CU</i>	<i>Reference to the Standard</i>
Purchase price	CU600,000 purchase price minus CU50,000 refundable purchase taxes	550,000	17.10(a)
Loan-raising fee	Offset against the measurement of the liability	—	11.13
Transport costs	Directly attributable expenditure	20,000	17.10(b)
Installation costs	Directly attributable expenditure	100,000	17.10(b)
Environmental restoration costs	The obligation to dismantle and restore the environment arose from the installation of the equipment	100,000	17.10(c)
Preparation costs	CU55,000 materials + CU65,000 labour + CU15,000 depreciation	135,000	17.10(b)
Training costs	Recognised as expenses in profit or loss	—	17.11(c)
Cost of testing	CU21,000 materials (net of the CU3,000 recovered from the sale of the scrapped output) + CU16,000 labour	37,000	17.10(b)
Operating loss	Recognised as expenses in profit or loss	—	17.10
Borrowing costs	Recognised as expenses in profit or loss	—	17.11(e) & 25.2
Cost of equipment		942,000	

Measurement of cost

- 17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments.

Example—Cost when payment is deferred

Ex 18 An SME acquired a piece of plant for CU2 million on two years' interest-free credit. An appropriate discount rate is 10% a year.

The cost of the plant is CU1,652,893 (the present value of the future payment).

Calculation: CU2,000,000 future payment $\times (1 \div (1.1)^2)$.

Note: The unwinding of the discount results in interest expense recognised in profit or loss of CU165,289 in the first year and CU181,818 in the second year after the acquisition. Furthermore, two years after the sale, the liability of CU2,000,000 (CU1,652,893 + CU165,289 + CU181,818) is derecognised upon settlement of the debt.

Exchanges of assets

- 17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset, or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of the acquired asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the carrying amount of the asset given up.

Educational notes

Although the Standard does not provide guidance on how to consider whether an exchange transaction has commercial substance or when the fair value of an asset is reliably measurable, full IFRS Accounting Standards do include such guidance.

In the absence of explicit guidance in the Standard an entity can, in accordance with paragraph 10.6, consider the requirements and guidance in full IFRS Accounting Standards.

In full IFRS Accounting Standards (see paragraph 25 of IAS 16 *Property, Plant and Equipment*) an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

Applying paragraph 26 of IAS 16, the fair value of an asset is reliably measurable if:

- (a) the variability in the range of reasonable fair value measurements is not significant for that asset; or
- (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

Example—Exchanges of assets

Ex 19 On 1 January 20X1 an SME exchanges an old truck for a boat. The old truck's carrying amount is CU500,000 and its fair value is CU750,000. The fair value of the boat can be measured reliably and is estimated as CU750,000. The transaction has commercial substance.

How does the SME account for the exchange of the old truck for the boat?

Dr	Property, plant and equipment (boat)	CU750,000 ^(a)	
	Cr	Property, plant and equipment (truck)	CU500,000
	Cr	Profit or loss	CU250,000 ^(b)

To record the exchange of the old truck for the boat on 1 January 20X1.

(a) Applying paragraph 17.14, the SME recognises the boat at a cost of CU750,000.

(b) On 1 January 20X1 the SME recognises a gain on the exchange of the old truck of CU250,000 in profit or loss.

Measurement after initial recognition

17.15 An entity shall choose either the cost model in paragraph 17.15A or the revaluation model in paragraph 17.15B as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. An entity shall apply the cost model to investment property whose fair value cannot be measured reliably without undue cost or effort. An entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

Cost-model

17.15A An entity shall measure an item of property, plant and equipment after initial recognition at cost less any accumulated **depreciation** and any accumulated **impairment losses**.

Revaluation model

17.15B An entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ **materially** from that which would be determined using fair value at the end of the **reporting period**. Section 12 *Fair Value Measurement* provides guidance on determining fair value. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

continued ...

17.15C If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in **other comprehensive income** and accumulated in **equity** under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

17.15D If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

Educational notes

A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

- land;
- land and buildings;
- machinery;
- motor vehicles; and
- office equipment.

If an SME chooses to apply the revaluation model, the Standard does not require items in a class of property, plant and equipment to be revalued simultaneously (unlike full IFRS Accounting Standards—see paragraph 38 of IAS 16). However, paragraph 17.15B requires that revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the end of the reporting period.

When an item of property, plant and equipment is revalued to fair value for the first time and fair value is higher than the previous carrying amount, the increase is credited to a revaluation surplus. Subsequent annual depreciation will be higher than it would have been without the revaluation.

The Standard, like full IFRS Accounting Standards, does not distinguish between categories of reserves, and does not set out how transfers between reserves should be made. In some jurisdictions, however, there are legal requirements about the creation and maintenance of specified reserves. Some entities choose to transfer an amount equal to the increase in depreciation from the revaluation surplus to retained earnings, as a reserve transfer. While it is possible to argue that this provides better information, it is not a requirement of the Standard. In some jurisdictions the balance in the revaluation surplus may be utilised to fund a bonus or capitalisation issue. If a bonus issue is funded out of a balance on revaluation surplus or if additional depreciation is transferred from revaluation surplus to retained earnings, the balance in the revaluation surplus will be lower at a subsequent date than it would otherwise have been. Consequently, if the asset is subsequently revalued downwards, a portion of that decrease might be recognised in profit or loss. Paragraph 17.15D limits the amount of the decrease that is recognised in other comprehensive income to the credit balance of the revaluation surplus.

Paragraph 17.15C describes how a revaluation gain is recognised and deals with the scenario in which an increase in value takes place after a revaluation decrease has already been recognised in profit or loss. The decrease is recognised in profit or loss when it is not the reversal of an earlier increase. A subsequent increase in value of the same asset is recognised in profit or loss to the extent that it reverses the revaluation decrease of the same asset, and any further increase in value is recognised in other comprehensive income. The amount of the subsequent increase that is recognised in profit or loss is limited to the amount of the revaluation decrease of the same asset previously recognised in profit or loss.

When an asset is revalued downwards below its carrying amount, the asset may or may not also be impaired. When the asset's recoverable amount is its value in use (see paragraph 27.11) that is higher than its previous carrying amount, the asset is not impaired. However, when it is impaired, Section 27 *Impairment of Assets* requires that the impairment loss for a revalued asset is treated as a revaluation decrease (see paragraph 27.6). Section 27 similarly requires that a reversal of an impairment loss for a revalued asset is treated as a revaluation increase (see paragraph 27.30(b)).

When a depreciable asset is revalued, depreciation is still charged for the period.

The balance relating to the asset that remains in the revaluation surplus at the time the asset is derecognised is permitted to be transferred out of the revaluation surplus to retained earnings.

This educational module does not address the deferred tax effects of recognising a revaluation surplus. These effects are discussed in Module 29 *Income Tax*.

Example—Measurement after initial recognition: cost model

Ex 20 At 31 December 20X1, an SME owns plant with an original cost of CU500,000 and accumulated depreciation of CU80,000. The SME determines that due to damage to the plant, an impairment of CU120,000 is necessary.

The SME uses the cost model for all its property, plant and equipment.

What is the carrying amount of the plant on 31 December 20X1?

	CU
Cost	500,000
Accumulated depreciation	(80,000)
Carrying amount before impairment	420,000
Impairment	(120,000)
Carrying amount	300,000

Examples—Measurement after initial recognition: revaluation model

Revaluation surplus

Ex 21 On 1 January 20X1, an SME acquired a piece of land for CU500,000. At 31 December 20X1, the land was valued at CU600,000. The SME uses the revaluation model for its land and buildings.

Ignoring the effects of deferred tax, how does the SME account for the increase in the value of the land for the year ended 31 December 20X1?

Dr	Land	CU100,000 ^(a)	
	Cr	Other comprehensive income—Revaluation ^(b)	CU100,000

To record the increase in the fair value of land at 31 December 20X1.

(a) Revaluation increase: CU600,000 – CU500,000 = CU100,000.

(b) The amount recognised in other comprehensive income is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Revaluation decrease reverses a previous revaluation increase

Ex 22 The facts are the same as in Example 21. At 31 December 20X2, the land was valued at CU300,000. The SME has concluded that the land is not impaired by also determining its value in use, which is higher than its carrying amount.

Ignoring the effects of deferred tax, how does the SME account for the revaluation of the land for the year ended 31 December 20X2?

Dr	Other comprehensive income—Revaluation ^(c)	CU100,000 ^(a)	
Dr	Profit or loss—Revaluation decrease	CU200,000 ^(b)	
	Cr	Land	CU300,000

To record the decrease in the fair value of the land at 31 December 20X2.

(a) The CU100,000 decrease is not an impairment because the value in use exceeds the carrying amount. Therefore, it reverses the previous revaluation increase recognised at 31 December 20X1.

(b) Decrease in revaluation at 31 December 20X2 = CU600,000 – CU300,000 = CU300,000.
Excess of decrease over previously recognised revaluation increase = CU300,000 – CU100,000 = CU200,000.

(c) The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus (see paragraph 17.15D).

Revaluation increase reversing previous revaluation decrease

Ex 23 On 1 January 20X1, an SME acquired a piece of land for CU500,000. At 31 December 20X1, the land was valued at CU300,000 but it was not assessed as being impaired because its value in use was determined to exceed its carrying amount. At 31 December 20X2, the land was valued at CU600,000.

Ignoring the effects of deferred tax, how does the SME account for the revaluation of the asset for the years ended 31 December 20X1 and 31 December 20X2?

31 December 20X1

Dr	Profit or loss—Valuation decrease	CU200,000 ^(a)	
	Cr Land		CU200,000

To record the decrease in the fair value of the land at 31 December 20X1.

31 December 20X2

Dr	Land	CU300,000 ^(b)	
	Cr Profit or loss		CU200,000 ^(c)
	Cr Other comprehensive income—Revaluation ^(e)		CU100,000 ^(d)

To record the increase in the value of the land at 31 December 20X2.

(a) Revaluation decrease for the year ended 31 December 20X1: CU500,000 – CU300,000 = CU200,000.

(b) Revaluation increase for the year ended 31 December 20X2: CU600,000 – CU300,000 = CU300,000.

(c) Reversal of the revaluation decrease previously recognised in profit or loss: CU200,000 (see (a)) (see paragraph 17.15C).

(d) The amount of revaluation increase for the year ended 31 December 20X2 of CU300,000 (see (b)) minus the reversal of previous revaluation decrease of CU200,000 (see (c)) = CU100,000.

(e) The amount recognised in other comprehensive income is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Revaluation surplus: effect of depreciation

Ex 24 An SME applies the revaluation model to its buildings. At 31 December 20X5, the SME's office building has a historical cost of CU500,000, a carrying amount of CU420,000, and a fair value of CU600,000.

How does the SME account for the revaluation of the building for the year ended 31 December 20X5?

Dr	Accumulated depreciation	CU80,000 ^(a)	
	Cr Cost	CU100,000 ^(b)	
	Cr Other comprehensive income—Revaluation ^(c)		CU180,000

To record the increase in the fair value of the office building at 31 December 20X5.

(a) To revalue the building at 31 December 20X5 to its fair value, one approach would be to reduce accumulated depreciation to nil. Section 17 does not specify whether to use this approach or to reflect all the revaluation gain in the cost line, so SMEs will make their own judgement.

- (b) The building's gross carrying amount would be increased (debited) by CU100,000 to arrive at the updated fair value of CU600,000.
- (c) The CU180,000 revaluation increase would be recognised in other comprehensive income. It is the difference between fair value of CU600,000 and carrying amount of CU420,000.
- The amount recognised in other comprehensive income is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Revaluation increase reversing previous revaluation decrease: effect of depreciation

Ex 25 On 1 January 20X1, an SME acquired an office building for CU500,000 with a useful life of 20 years and a nil residual value. From 31 December 20X1 through to 31 December 20X4, the carrying amount of the building was not materially different from the fair value and therefore no adjustments for revaluation were required. At 31 December 20X5, the building has a fair value of CU300,000. The SME uses the revaluation model. From 31 December 20X6 through to 31 December 20X9, the carrying amount was not materially different from the fair value and therefore no adjustments for revaluation were required. However, during the year 20Y0 there has been a significant increase in property prices. At 31 December 20Y0, the building was valued at CU400,000.

Ignoring the effects of deferred tax, how does the SME account for the revaluation of the asset for the years ended 31 December 20X5 and 31 December 20Y0?

31 December 20X5

Dr	Accumulated depreciation	CU125,000	
Dr	Profit or loss—Revaluation decrease	CU75,000 ^(a)	
	Cr	Office building	CU200,000

To record the decrease in the value of the asset for the year ended 31 December 20X5.

31 December 20Y0

Dr	Accumulated depreciation	CU100,000 ^(b)	
Dr	Office building	CU100,000	
	Cr	Profit or loss	CU75,000 ^(c)
	Cr	Other comprehensive income—Revaluation ^(e)	CU125,000 ^(d)

To record the increase in the value of the asset at 31 December 20Y0.

- (a) Annual depreciation: $\text{CU}500,000 \div 20 \text{ years} = \text{CU}25,000$
 Cumulative depreciation: $20\text{X}1 \text{ to } 20\text{X}5 = \text{CU}25,000 \times 5 \text{ years} = \text{CU}125,000$
 Carrying amount at 31 December 20X5 = $\text{CU}500,000 - \text{CU}125,000 = \text{CU}375,000$
 Revaluation decrease at 31 December 20X5: $\text{CU}375,000 - \text{CU}300,000 = \text{CU}75,000$.
- (b) Annual depreciation: $20\text{X}6 \text{ to } 20\text{Y}0 = \text{CU}300,000 \div 15 \text{ years} = \text{CU}20,000$
 Cumulative depreciation: $20\text{X}6 \text{ to } 20\text{Y}0 = \text{CU}20,000 \times 5 \text{ years} = \text{CU}100,000$.
- (c) Applying paragraph 17.15C, the CU75,000 previously recognised in profit or loss is reversed.
- (d) Carrying amount at 31 December 20Y0 = $\text{CU}300,000 - \text{CU}100,000 = \text{CU}200,000$
 Revaluation increase at 31 December 20Y0 = $\text{CU}400,000 - \text{CU}200,000 = \text{CU}200,000$
 Amount recognised in other comprehensive income at 31 December 20Y0 = $\text{CU}200,000 - \text{CU}75,000 = \text{CU}125,000$.
- (e) The amount recognised in other comprehensive income is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Depreciation

- 17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

Example—Depreciation of major components

Ex 26 On 1 January 20X1, an SME acquired an item of heavy machinery for CU600,000. The machine is made up of three components of equal value:

- fixed parts—the SME estimates the fixed parts have a 25-year useful life with no residual value;
- moving parts—the SME estimates the moving parts have a five-year useful life with no residual value; and
- a foundation—the SME estimates the foundation has a 25-year useful life with no residual value.

Furthermore, the SME has selected the straight-line method of depreciation for all components of the machine.

How does the SME allocate the cost of the asset to its major components?

The SME allocates the CU600,000 initially recognised to the three components of the machine. However, fixed parts and the foundation may be grouped together in determining the depreciation charge because these components have the same useful life and both will be depreciated using the straight-line method (paragraph 17.22 specifies the requirement for selecting a depreciation method). One third of the cost (or CU200,000) will be allocated to the moving parts and two thirds of the cost (or CU400,000) will be allocated to the combined foundation and fixed parts.

In 20X1 the depreciation expense for the machine will be CU56,000 ((CU400,000 ÷ 25 years) + (CU200,000 ÷ 5 years)).

-
- 17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this Standard requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

Educational notes

The depreciation charge for a period is usually recognised in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see paragraph 13.8 of Section 13).

Examples—Depreciation charge allocated to the cost of an asset

Ex 27 On 1 January 20X1, an SME acquired a machine for CU1,200,000. The SME estimates the machine has a 10-year useful life (measured from the date of acquisition) and a nil residual value. Furthermore, the SME has selected the straight-line method of depreciation for all components of the machine.

In 20X1 the machine was used to produce inventory for eight months. Thereafter, the machine was used to manufacture components of a new item of plant being constructed by the SME.

The SME accounts for the machine using the cost model.

Depreciation for the year is CU120,000 ($\text{CU1,200,000} \div 10 \text{ years}$). In 20X1 the SME allocates CU80,000 ($(8 \div 12 \text{ months}) \times \text{CU120,000}$) to the cost of inventories manufactured in 20X1 and CU40,000 to the cost of the new plant undergoing construction ($(4 \div 12 \text{ months}) \times \text{CU120,000}$).

Ex 28 The facts are the same as in Example 26 except the SME uses the revaluation model for the machine. The machine is revalued to CU1,300,000 after depreciating the machine by CU120,000 in 20X1.

In 20X1 the SME allocates CU80,000 ($(8 \div 12 \text{ months}) \times \text{CU120,000}$) to the cost of inventories manufactured in 20X1 and CU40,000 to the cost of the new plant undergoing construction ($(4 \div 12 \text{ months}) \times \text{CU120,000}$).

The revaluation increase recognised in other comprehensive income and accumulated in the revaluation surplus in equity is CU220,000 ($\text{CU1,300,000} - \text{CU1,080,000}$). Depreciation in 20X2 is based on the revalued amount of CU1,300,000. Depreciation for 20X2 is CU144,444 ($\text{CU1,300,000} \div 9 \text{ years remaining}$).

Depreciable amount and depreciation period

- 17.18 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.
- 17.19 Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement and changes in market prices may indicate that the **residual value** or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an **accounting estimate** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Educational notes

The depreciable amount is defined in the Glossary as ‘the cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value’.

The residual value is defined in the Glossary as the estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value is based on current market prices for an asset in comparable condition, not the amount that the entity expects it will obtain at the end of the useful life.

Useful life is defined in the Glossary as 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. Therefore, the useful life of an asset might be shorter than its economic life. See examples on determining the useful life under paragraph 17.21.

Paragraph 17.22 sets out how to select a depreciation method to allocate the depreciable amount over the useful life.

When an entity applying paragraph 17.19 concludes that there is a change in accounting estimate, the entity then applies paragraph 10.16 and recognises the effect of a change in an accounting estimate prospectively by including it in profit or loss in:

- the period of the change, if the change affects that period only; or
- the period of the change and future periods, if the change affects both.

Example—Revised assessment of depreciation

Ex 29 On 1 January 20X1, an SME acquired a machine for CU500,000. The SME accounts for the machine using the cost model. The SME estimated the useful life of the machine as 20 years and its residual value as nil. Furthermore, the SME has selected the straight-line method of depreciation for all components of the machine.

At 31 December 20X5, the SME's financial year end, the SME's assessments of the useful life and residual value of the machine changed. It now estimates the useful life of the machine as 25 years (measured from the date of acquisition) and its residual value as CU100,000.

How does the SME account for the revised assessment of the machine in the year ended 31 December 20X5?

Dr	Profit or loss—Depreciation expense	CU14,286 ^(a)	
	Cr	Accumulated depreciation	CU14,286

To record depreciation expense for the year ended 31 December 20X5.

(a) Depreciation expense = (CU400,000^(b) – CU100,000 residual value) ÷ 21 years' remaining useful life at the beginning of the current reporting period = CU14,286.

Applying paragraph 10.16, the depreciation for the period of change (20X5) and for future periods (over the revised remaining useful life) is adjusted.

(b) CU500,000 cost minus (4 years × CU25,000^(c) annual depreciation) = CU400,000 carrying amount at 1 January 20X5 (that is, the carrying amount carried forward from 31 December 20X4).

(c) Original annual depreciation = CU500,000 ÷ 20 years = CU25,000.

- 17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

Example—Beginning and ceasing depreciation

Ex 30 On 1 January 20X1, an SME acquired a machine for CU3 million. The SME estimated the useful life of the machine as 20 years and its residual value as nil.

The machine was installed and ready for use as intended by 1 February 20X1. However, because of unexpected delays in the retraining of staff to operate the machine, production began on 1 March 20X1.

From 1 June 20X3 to 31 July 20X3 the machine was idle because the employees that operate the machine had embarked on industry-wide industrial action in the form of a stay away.

On 30 September 20X5 the SME decided to dispose of the machine. On 15 October 20X5 management informed the machine operators of this decision and advertised the machine for sale in the local and industry press. On 1 November 20X5 the SME entered into negotiations with an independent third party for the sale of the machine. A binding sale agreement was signed on 2 February 20X6 and the buyer immediately took the machine, so control of the machine was also transferred from the SME to the buyer on this date.

When does the SME start to depreciate the machine?

The SME starts depreciating the machine on the date it is available for use. This is 1 February 20X1, when it was installed in the SME's factory and was in a condition necessary for it to be capable of operating in the manner intended by management.

When does the SME cease depreciating the machine?

The SME ceases depreciating the machine when the machine is derecognised (that is, when it is disposed of on 2 February 20X6).

Note—the machine continues to be depreciated after the decision that its carrying amount will be recovered principally through a sale transaction and after sale negotiations with a third party begin. However, applying paragraph 27.9(f), a plan to dispose of an asset before the previously expected date triggers an impairment test (see paragraph 17.26).

Does the SME temporarily suspend depreciation of the machine between 1 June and 31 July 20X3?

No, the SME does not temporarily suspend depreciating the machine when it is idle. Depreciation of an asset ceases only when the asset is derecognised or it is fully depreciated. However, under usage methods of depreciation (such as the units of production method) the depreciation charge can be nil while there is no production.

- 17.21 An entity shall consider all the following factors in determining the useful life of an asset:
- (a) the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
 - (b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
 - (c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset.
 - (d) legal or similar limits on the use of the asset, such as the expiry dates of related **leases**.

Examples—Useful life of an asset

- Ex 31** As part of their remuneration package an SME provides each senior manager with the private use of a luxury motor vehicle of the manager's choice. The executive motor vehicles are replaced every two years irrespective of usage.

The SME sells and replaces its luxury motor vehicle fleet every two years although the vehicles are expected to be economically usable by one or more drivers for at least another three years.

The useful life of the vehicles to the SME is two years. The fact that the vehicles could be operated for five years is not relevant to the assessment of their useful life. Useful life is the period over which the vehicles are expected to be available for use by the SME (that is, two years).

- Ex 32** An SME does not plan to service its equipment regularly. With regular servicing the equipment would be available for use for five years. However, the expected equipment servicing pattern is expected to render the equipment unusable in three years.

The useful life of the equipment to the SME is three years (the period over which the equipment is expected to be available for use by the SME, taking account of expected levels of servicing). The fact that regular servicing would extend the life of the equipment to five years is irrelevant because the SME does not expect to undertake regular servicing.

If the facts were different and the SME expected to undertake regular servicing, the useful life would be five years and the SME would depreciate the equipment over this longer period.

- Ex 33** An SME's equipment used to manufacture a patented drug is expected to be capable of producing the drug for 10 years. However, the SME expects to stop manufacturing the drug and scrap the equipment after five years of production when its patent will expire and after low-cost generic drugs are expected to render the SME's manufacturing of this drug unprofitable.

The useful life of the equipment to the SME is five years (the period over which the equipment is expected to be available for use by the entity, taking account of expected production patterns). The fact that the equipment is expected to be fit for purpose for 10 years is irrelevant because the SME expects to stop operating the equipment after five years.

- Ex 34** An SME has the right of use of an item of equipment applying the terms of a finance lease. The equipment is capable of operating for 15 years. However, the lease term is 13 years and the SME is required to return the equipment to the lessor at the end of the lease term.

The useful life of the equipment to the SME is the 13-year lease term, the period over which the equipment is expected to be available for use by the SME taking account of limits imposed by the lease. The fact that the equipment is expected to be fit for purpose for an additional two years is irrelevant because the SME does not expect to use the asset for that additional two-year period.

Depreciation method

- 17.22 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method. A depreciation method that is based on **revenue** generated by an activity that includes the use of an asset is not appropriate.

Educational notes

The depreciation method used is not a free choice. The depreciation method is that which best matches the way in which the asset's economic benefits are expected to be consumed as the entity uses the asset. Furthermore, this might not be the same method as allowed for tax purposes. Whatever the depreciation method, the depreciation rate must reduce the carrying amount of the asset to the asset's residual value by the end of its useful life.

The explicit requirement for an entity not to use a revenue-based depreciation method was added in the third edition of the Standard, reflecting a comparable change made in IAS 16. A revenue-based depreciation method would not be appropriate for an entity to use because the revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices, which do not reflect the way the asset is consumed. Also, the price component of revenue might be affected by inflation, which again has no bearing upon the way in which an asset is consumed.

Examples—Depreciation method

- Ex 35 An SME uses a machine in the production of hazardous chemicals. Industry regulations limit the output of the machine to 1 million litres, after which the machine must be decommissioned, decontaminated and recycled. The SME projects that the output of the machine will reach 1 million litres within four years of its acquisition.**

The units of production method is probably the most appropriate depreciation method for the SME to apply in depreciating the machine. This method reflects the pattern in which the SME expects to consume the asset's future economic benefits. Using this method, 1/1,000,000 of the cost of the machine would be included in the cost of each litre of chemical produced by the machine (assuming the SME accounts for the machine using the cost model). If usage varied from one period to the next, the straight line method of depreciation would not reflect the pattern in which the SME expects to consume the machine's future economic benefits.

The volume of output from the machine each year will affect the SME's revenue, but a revenue-based depreciation method is not permitted by the Standard and would be less closely linked to how the machine's future economic benefits are expected to be consumed.

Ex 36 An SME provides each senior manager with the private use of a luxury motor vehicle of the manager's choice, as part of their remuneration package. The executive motor vehicles are replaced every two years irrespective of usage.

The straight-line method is probably the most appropriate depreciation method for the SME to apply in depreciating the executive motor vehicles. This method reflects the pattern in which the SME expects to consume the assets' future economic benefits. Using this method, half of the depreciable amount of the vehicle would be included in depreciation expense each year. However, the SME might need to reconsider the residual value of the vehicles if usage is not in line with expectations.

17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset's future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with Section 10.

Example—Change in depreciation method

Ex 37 On 1 January 20X1 an SME acquired a machine for CU500,000. The SME estimated the machine's residual value as nil. At the SME's 31 December 20X5 financial year-end its assessment of the machine changed. The SME changed the depreciation method from the diminishing balance method at the rate of 8% per year to the straight-line method at the rate of 6% per year because the SME judged it to better reflect the pattern in which the SME expects to consume the machine's remaining future economic benefits.

How does the SME account for the revised assessment of its machine for the year ended 31 December 20X5?

Dr	Profit or loss—Depreciation expense	CU21,492 ^(a)	
	Cr	Accumulated depreciation	CU21,492

To record depreciation expense for the year ended 31 December 20X5.

(a) $\text{CU}358,196^{(b)} \times 6\% = \text{CU}21,492$

(b) Year end	Depreciation per year	Carrying amount at the end of the year
20X1	$\text{CU}500,000 \times 8\% = \text{CU}40,000$	$\text{CU}460,000 (\text{CU}500,000 - \text{CU}40,000)$
20X2	$\text{CU}460,000 \times 8\% = \text{CU}36,800$	$\text{CU}423,200 (\text{CU}460,000 - \text{CU}36,800)$
20X3	$\text{CU}423,200 \times 8\% = \text{CU}33,856$	$\text{CU}389,344 (\text{CU}423,200 - \text{CU}33,856)$
20X4	$\text{CU}389,344 \times 8\% = \text{CU}31,148$	$\text{CU}358,196 (\text{CU}389,344 - \text{CU}31,148)$

Impairment

Recognition and measurement of impairment

- 17.24 At each reporting date, an entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Compensation for impairment

- 17.25 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation becomes receivable.

Example—Impairment

- Ex 38** On 30 September 20X6 a fire damaged an SME's machine when the machine's carrying amount was CU500,000 (cost CU600,000 minus CU100,000 accumulated depreciation). The machine was no longer usable after the fire and would have a scrap value of only CU5,000. The SME immediately registered a claim with its insurance company of CU700,000 for the replacement cost of the machine. However, the insurance company disputed the claim, citing negligence by the SME.

On 15 November 20X6 the fire authorities completed their investigation and informed the insurance company and the SME that an electrical fault caused the fire. As a result of these findings the insurance company notified the SME that its claim for CU700,000 would be settled in full. The insurance company paid the SME CU700,000 on 30 November 20X6.

On 15 December the SME utilised the CU700,000 to acquire a replacement machine, which was immediately installed and ready for use. At the same time it scrapped the damaged machine and received proceeds of CU5,000.

How does the SME account for its machinery for the year ended 31 December 20X6?

30 September 20X6

Dr	Profit or loss—Impairment of machinery	CU495,000	
	Cr	Accumulated depreciation and accumulated impairment (machinery)	CU495,000

To record impairment of a machine destroyed by fire, reducing carrying amount to its scrap value.

15 November 20X6

Dr	Receivable	CU700,000	
	Cr	Profit or loss—Insurance compensation	CU700,000

To record the compensation to be received from the insurance company in respect of a machine destroyed by fire.

30 November 20X6

Dr	Cash	CU700,000	
	Cr	Receivable	CU700,000

To record receipt of the compensation from the insurance company in respect of a machine destroyed by fire.

15 December 20X6

Dr	Property, plant and equipment (machine, cost)	CU700,000	
	Cr	Cash	CU700,000

To record the acquisition of the new machine.

Dr	Cash	CU5,000	
Dr	Accumulated depreciation and accumulated impairment	CU495,000	
	Cr	Plant (gross carrying amount)	CU500,000

To record the scrapping and derecognition of a machine destroyed by fire.

Property, plant and equipment held for sale

- 17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

Educational notes

Example 30 illustrates a situation in which an entity plans to dispose of an asset before the previously expected date.

Derecognition

- 17.27 An entity shall derecognise an item of property, plant and equipment:
- (a) on disposal; or
 - (b) when no future economic benefits are expected from its use or disposal.

Examples—Derecognition

- Ex 39** On 14 December 20X5, an SME sold a machine. The purchaser took immediate delivery of the machine.

The SME derecognises the machine on 14 December 20X5 when the promise to transfer the item to the purchaser is fulfilled and the purchaser obtains control of the machine (see paragraph 17.29).

- Ex 40** On 31 December 20X4, because of slow sales, an SME temporarily removed its cardboard box manufacturing machine from production. Expecting that demand for cardboard boxes would increase in the near future, the SME did not dispose of the machine.

On 30 June 20X6, the SME stopped expecting market conditions to improve to the extent that it could restart the manufacture of cardboard boxes. It therefore decided to scrap its cardboard box manufacturing machine. The scrapped machine was physically dumped at the local industrial waste site on 15 July 20X6.

Although the machine was not being used on 31 December 20X4 and 31 December 20X5, it is not derecognised at either date because future economic benefits are still expected from its use or disposal. At 31 December 20X4 the entity would carry out an impairment test and at 31 December 20X5 it would consider whether another impairment test should be performed.

On 30 June 20X6 the SME derecognises the machine. From this date no future economic benefits are expected from its use or disposal.

- 17.28 An entity shall recognise the gain or loss on the **derecognition** of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.

Examples—When to recognise a gain or loss on derecognition

- Ex 41** On 14 December 20X5, an SME sold a machine with a carrying amount of CU20,000 for CU35,000. The purchaser took immediate delivery of the machine.

The SME derecognises the machine on 14 December 20X5, when the purchaser obtains control of the machine (see paragraph 17.29). Income (a gain on disposal of equipment) of CU15,000 is recognised in profit or loss on 14 December 20X5.

Ex 42 The facts are the same as in Example 40. On 31 December 20X4 the machine was impaired, reducing its carrying amount by CU4,000 to CU8,000.

The CU4,000 impairment loss is recognised in profit or loss on 31 December 20X4.

At each subsequent reporting date (that is, on 31 December 20X5, assuming the SME does not prepare interim financial reports), the SME considers whether a further impairment test should be performed (see Section 27).

On 31 July 20X6 (the date of disposal) the SME recognises in profit or loss the CU2,550 loss on disposal of the machine. The loss (CU2,550) is the amount by which the machine's carrying amount (CU7,550) exceeds the proceeds from its disposal (CU5,000).

Assuming no further impairment or reversal of the impairment at 31 December 20X5, CU450 depreciation would have been charged to profit or loss from 1 January 20X5 to 30 June 20X6 (CU8,000 carrying amount on 1 January 20X5 – CU5,000 residual value = CU3,000 depreciable amount. $\text{CU3,000} \div 10 \text{ years remaining useful life} = \text{CU300 depreciation a year}$. $\text{CU300} \times (18 \div 12 \text{ months}) = \text{CU450 depreciation for 18 months}$).

17.29 The date of disposal of an item is the date the recipient obtains control of that item in accordance with the requirements in paragraphs 23.57–23.61 for determining when a promise is fulfilled. Section 20 applies to disposal by a sale and leaseback.

Example—Date of disposal

Ex 43 On 8 August 20X5 an SME sold a machine on credit for CU40,000. The purchaser took immediate delivery of the machine. However, the SME retained legal title of the item until the purchaser settled the purchase price, as security for the payment. The withholding of legal title is not intended to restrict the purchaser's use of the machine. The purchaser paid the SME in full on 8 September and legal title immediately passed to the purchaser.

The SME derecognises the machine on 8 August 20X5. At this date control of the machine passed to the purchaser. Not all of the indicators of transfer of control in paragraph 23.58 are present (in particular, legal title has not passed). However, as described in paragraph 23.59, it is clear from other features of the transaction (for example, the fact that the purchaser has physical possession and can use the machine) that the purchaser has the present ability to direct the use of the machine and obtain the economic benefits that might flow from it. Therefore, the SME concludes that control has passed to the purchaser and derecognises the machine at that point.

-
- 17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Educational notes

This requirement applies regardless of whether the revaluation model or cost model is applied for property, plant and equipment.

When an entity sells an item of property, plant and equipment that it had carried using the revaluation model, a balance related to that asset might remain in the revaluation surplus at the date of sale.

The Standard does not prescribe how, when or if amounts can be transferred between components of equity. These decisions are left to the discretion of preparers, subject to the constraints imposed by Section 2. Section 2 states that the fundamental qualitative characteristics of financial information are relevance and faithful representation. Some entities might choose to transfer some or all of the accumulated balance in respect of the asset from the revaluation surplus directly to retained income or to another component of equity. For some entities, such transfers might be mandated or prohibited by local legislation.

Examples—Gain or loss on derecognition

- Ex 44** On 1 November 20X5 an SME sold an owner-occupied building for CU3.5 million. The building had a carrying amount of CU2million at the date of sale. The estate agent retained a commission of 10% of the sale proceeds. Legal fees in respect of the sale were CU10,000. The SME had been accounting for the building using the cost model.

On 1 November 20X5 the SME recognises a gain on the disposal of the building of CU1,140,000 in profit or loss.

Calculation: CU3,500,000 selling price – CU350,000 agent's commission – CU10,000 legal fees = CU3,140,000 net disposal proceeds.

CU3,140,000 net disposal proceeds – CU2,000,000 carrying amount = CU1,140,000 gain on disposal of the building.

- Ex 45** The facts are the same as in Example 44 except that the SME was accounting for the building using the revaluation model. At the date of disposal the building's carrying amount was CU3 million.

On 1 November 20X5 the SME recognises a gain on the disposal of the building of CU140,000 in profit or loss.

CU3,140,000 net disposal proceeds (the same as in Example 44) – CU3,000,000 carrying amount = CU140,000 gain on disposal of building.

The SME might choose, local law permitting, to transfer the balance on its revaluation surplus for this property to its retained earnings reserve or to another reserve. If the SME transferred the balance to retained earnings, the balance on retained earnings would be the same as it would have been if the building had been accounted for using the cost model.

Disclosures

17.31 An entity shall disclose the following for each class of property, plant and equipment determined in accordance with paragraph 4.11(a) and separately for investment property carried at cost less accumulated depreciation and impairment:

- (a) the measurement bases used for determining the gross carrying amount;
- (b) the depreciation methods used;
- (c) the useful lives or the depreciation rates used;
- (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period; and
- (e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
 - (i) additions;
 - (ii) disposals;
 - (iii) acquisitions through **business combinations**;
 - (iv) increases or decreases resulting from revaluations under paragraphs 17.15B–17.15D and from impairment losses recognised or reversed in other comprehensive income in accordance with Section 27;
 - (v) transfers to and from investment property carried at fair value through profit or loss (see paragraph 16.8);
 - (vi) impairment losses recognised or reversed in profit or loss in accordance with Section 27;
 - (vii) depreciation; and
 - (viii) other changes.

This reconciliation need not be presented for prior periods.

Educational notes

In accordance with paragraph 4.11(a), an entity is required to disclose property, plant and equipment in classifications appropriate to the entity. A class of assets is a grouping of assets of a similar nature and use in an entity's operations (see the Glossary). The following are examples of separate classes of property, plant and equipment:

- land;
- land and buildings;
- machinery;
- boats;
- aircraft;
- motor vehicles;
- furniture and fixtures; and
- office equipment.

Example—Classes

Ex 46 An SME has the following items of property, plant and equipment:

- **Property A**, a vacant plot of land on which it intends to construct its new administration headquarters;
- **Property B**, a plot of land that it operates as a landfill site;
- **Property C**, a plot of land on which its existing administration headquarters are built;
- **Property D**, a plot of land on which its direct sales office is built;
- **Properties E1–E10**, 10 separate retail outlets and the land on which they are built;
- **Equipment A**, computer systems at its headquarters and direct sales office that are integrated with the point-of-sale computer systems in the retail outlets;
- **Equipment B**, point-of-sale computer systems in each of its retail outlets;
- **furniture and fittings** in its administrative headquarters and its sales office; and
- **shop fixtures and fittings** in its retail outlets.

The SME's only investment property is **Property F**—a vacant plot of land held for capital appreciation. The fair value of the plot of land cannot be measured reliably without undue cost or effort on an ongoing basis.

How many classes of property, plant and equipment will the SME disclose?

The SME's management applies judgement to answer this question.

A class of assets is defined in the Glossary as a grouping of assets of a similar nature and use in an entity's operations.

The nature of land without a building is different to the nature of land with a building.

Consequently, land without a building is a separate class of asset from 'land and buildings'. Furthermore, the nature and use of land operated as a landfill site is different from vacant land. Although the nature of Property A and Property F are probably the same, because Property F is being held as an investment property, the SME discloses it separately from property, plant and equipment as required by paragraph 4.2. The SME applies judgement to determine whether its retail outlets are sufficiently different in nature and use from its office buildings and therefore constitute a separate class of land and buildings.

The computer equipment is integrated across the organisation and would probably be classified as a single separate class of asset.

Furniture and fittings used for administrative purposes could be sufficiently different to shop fixtures and fittings in retail outlets to be classified in two separate classes of assets.

Example—Disclosures to comply with paragraph 17.31

Ex 47 An SME applying the cost model could present the paragraph 17.31 disclosures for each class of property, plant and equipment as follows:

Note 1 Accounting policies (extract)	
<i>Property, plant and equipment</i>	
Items of property, plant and equipment are measured at cost minus accumulated depreciation and accumulated impairment losses. Depreciation is charged to allocate the cost of the assets minus their residual values over their estimated useful lives, using the straight-line method. Land has an indefinite useful life and is therefore not depreciated. The estimated useful lives of the other items of property, plant and equipment are:	
• Buildings	60 years
• Machinery	10 years
• Office equipment	3 years

Note 4 Property, Plant and Equipment

	<i>Vacant land</i>	<i>Land and buildings</i>	<i>Machinery</i>	<i>Office equipment</i>	<i>Total</i>
	<i>CU'000</i>	<i>CU'000</i>	<i>CU'000</i>	<i>CU'000</i>	<i>CU'000</i>
Cost	1,100	10,000	13,000	4,400	28,500
Accumulated depreciation		(4,133)	(3,200)	(2,300)	(9,633)
Carrying amount at 1 January 20X2	1,100	5,867	9,800	2,100	18,867
Additions			2,000	1,000	3,000
Acquired in a business combination		5,000	4,000	2,000	11,000
Disposals		(1,400) ^(a)	(1,200) ^(c)	(300) ^(e)	(2,900)
Depreciation		(243)	(1,700)	(2,250)	(4,193)
Impairment			(600)		(600)
Exchange difference on translation of a foreign operation	(200)				(200)
Carrying amount at 31 December 20X2	900	9,224	12,300	2,550	24,974
Cost	900	13,000 ^(b)	16,000 ^(d)	6,400 ^(f)	36,300
Accumulated depreciation		(3,776) ^(b)	(3,700) ^(d)	(3,850) ^(f)	(11,326)

Note: these calculations illustrate the workings only and would not be part of the actual disclosures in the financial statements.

Calculations (in CU'000)

(a) CU2,000 cost – CU600 accumulated depreciation.

(b) CU10,000 + CU5,000 – CU2,000^(a) and CU4,133 + CU243 – CU600^(a).

(c) CU3,000 cost – CU1,800 accumulated depreciation.

(d) CU13,000 + CU2,000 + CU4,000 – CU3,000^(c) and CU3,200 + CU1,700 + CU600 – CU1,800^(c).

(e) CU1,000 cost – CU700 accumulated depreciation.

(f) CU4,400 + CU1,000 + CU2,000 – CU1,000^(e) and CU2,300 + CU2,250 – CU700^(e).

17.32 An entity shall also disclose the following:

- (a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for **liabilities**;
- (b) the amount of contractual commitments for the acquisition of property, plant and equipment; and
- (c) if an entity has investment property whose fair value cannot be measured reliably without undue cost or effort it shall disclose that fact and the reasons why fair value measurement would involve undue cost or effort for those items of investment property.

Example—Disclosures to comply with paragraph 17.32

Ex 48 An SME could present other disclosures about property, plant and equipment as follows:

Note 4 Property, Plant and Equipment (extract)
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At 31 December 20X2 the entity's property with a carrying amount of CU120,000 was pledged as security for a CU100,000 loan from Bank B. This pledge existed at 31 December 20X1.
--

At 31 December 20X2 the entity had contracted Entity A to construct an office block. The CU1,000,000 fixed-price contract required construction to begin by 30 June 20X4 and to be completed by 30 June 20X5. The entity had no contractual commitments for the acquisition of property, plant and equipment at 31 December 20X1.

17.33 If items of property, plant and equipment are stated at revalued amounts, an entity shall disclose the following:

- (a) the effective date of the revaluation;
- (b) whether an independent valuer was involved;
- (c) [deleted]
- (d) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and
- (e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Educational notes

Section 17 previously included a requirement (in paragraph 17.33(c)) to disclose the methods and significant assumptions applied in estimating the fair values of items of property, plant and equipment stated at revalued amounts.

The disclosure requirements now appear in Section 12, where paragraph 12.28(c) requires ‘a description of the valuation technique(s) the entity used for fair value measurements categorised in Level 2 and Level 3 of the fair value hierarchy, and the inputs used in the fair value measurement’.

Entities might choose to include the fair value disclosures that relate to property, plant and equipment with the other property, plant and equipment disclosures.

Example—Disclosures to comply with paragraph 17.33

Ex 49 An entity applying the revaluation model to land and buildings could present the disclosures required by paragraph 17.33(a)–(e) as follows:

Note 1 Accounting policies (extract)	
<i>Property, plant and equipment</i>	
Land and buildings are measured at fair value based on valuations by independent valuers, minus subsequent depreciation for buildings. Revaluations are performed at least as often as every three years, unless it is considered necessary to perform them more frequently to ensure that at the end of the reporting period, the carrying amount does not differ materially from fair value. All other items of property, plant and equipment are measured at cost minus accumulated depreciation and accumulated impairment losses.	
Increases in the carrying amount of land and buildings because of a revaluation are recognised in other comprehensive income and accumulated in equity as revaluation surplus unless they reverse a revaluation decrease of the same asset previously recognised in profit or loss—in which case the increase is recognised in profit or loss. Decreases in the carrying amount of land and buildings due to a revaluation are recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of the same asset. All other decreases are recognised in profit or loss.	
Depreciation is charged to allocate the cost or valuation of assets minus their residual values over their estimated useful lives, using the straight-line method. Land has an indefinite useful life and is therefore not depreciated. The estimated useful lives of the other items of property, plant and equipment are:	
• Buildings	60 years
• Machinery	10 years
• Office equipment	3 years.

Note 4 Property, Plant and Equipment (extract)

Fair values of land and buildings

The land and buildings were valued at 31 December 20X2 by an independent valuer. The fair values are based on recent arm's length market transactions for similar properties.

For land and buildings carried under the cost model, the carrying amount would be as follows:

	20X2	20X1
	CU	CU
Cost	4,250,000	3,000,000
Accumulated depreciation	(1,000,000)	(250,000)
Carrying amount	<u>3,250,000</u>	<u>2,750,000</u>

Revaluation surplus

The revaluation surplus arises on the revaluation of land and buildings.

	20X2	20X1
	CU	CU
Balance at beginning of year	3,000,000	3,000,000
Increase arising on revaluation of land and buildings	1,000,000	—
Impairment losses	—	—
Balance at end of year	<u>4,000,000</u>	<u>3,000,000</u>

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the Standard to transactions and events often requires an entity to use its judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful to a user of financial statements assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 of Section 8 *Notes to the Financial Statements*, an entity must disclose the judgements that management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7, an entity discloses information that explains key assumptions about the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the Standard require disclosure of information about particular judgements and estimation uncertainties.

Classification

Property, plant and equipment are tangible assets held for use in the production or supply of goods or services, for administrative purposes or for rental to others (unless the asset is classified as an investment property). Furthermore, these assets are expected to be used during more than one period. In most cases entities encounter little difficulty determining whether a property is an item of property, plant and equipment. However, significant judgement is required to classify some items of property. For example:

- some properties comprise a portion held to earn rentals or for capital appreciation and another portion held for use in the production or supply of goods or services or for administrative purposes. Such mixed-use property should be separated between investment property and property, plant and equipment. Determining which portion should be classified as investment property and which portion should be classified as property, plant and equipment might require judgement.
- some entities provide ancillary services to the occupants of a property they hold and rent out, such as security and maintenance. In many cases, security and maintenance services will be insignificant, so the building would be classified as investment property. In other cases, an entity might rent out fully furnished offices including services such as information technology systems and administration. Such arrangements are in the nature of the provision of a service and the property would be classified as owner-occupied and accounted for as property, plant and equipment. However, there are cases where it might be difficult to judge whether the property should be classified as property, plant and equipment or as investment property.

For cases in which significant judgement is needed to determine whether a property qualifies as property, plant and equipment, an entity should develop criteria so that it can exercise that judgement consistently.

When the fair value of an investment property can be measured reliably without undue cost or effort on an ongoing basis, an entity measures the investment property at its fair value. Otherwise, investment property is measured using the cost model in Section 17. An entity's management must apply judgement in determining whether the fair value of an investment property can be measured reliably without undue cost or effort on an ongoing basis. Section 12 provides guidance on determining fair value and paragraphs 2.28–2.31 of Section 2 provide guidance on the meaning of undue cost or effort.

To report on property, plant and equipment it is necessary to separate the items into classifications appropriate to the entity (see paragraph 17.31). A class of assets is a grouping of assets of a similar nature and use in an entity's operations (see the Glossary). In most cases, an entity encounters little difficulty classifying items of property, plant and equipment. However, significant judgement might be required to classify some items.

Measurement

An entity shall measure property, plant and equipment at its cost at initial recognition.

Significant judgements in measuring the cost of an item of property, plant and equipment at initial recognition might include:

- *if payment for the item is deferred beyond normal credit terms*—determining the discount rate at which to discount all future payments to arrive at the present value that will be included in the cost of the property;
- *if the item is acquired in an exchange for a non-monetary asset*—estimating the fair value of the non-monetary asset; and
- *if applicable*—estimating the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs when the item is acquired.

After initial recognition an entity must measure all items of property, plant and equipment either applying the cost model (that is, at cost minus any accumulated depreciation and any accumulated impairment losses) or applying the revaluation model (that is, at fair value minus subsequent accumulated depreciation and any subsequent accumulated impairment losses). Significant judgements in accounting for the depreciation of property, plant and equipment might include:

- allocating the amount initially recognised for an item of property, plant and equipment to its major components that are required to be depreciated separately, in accordance with paragraph 17.16;
- estimating the useful life of the item (or significant part of the item) of property, plant and equipment;
- estimating the residual value of the item of property, plant and equipment (or a significant part of the item); and
- determining the appropriate depreciation method that reflects the pattern in which the entity expects to consume the item of property, plant and equipment (or a significant part of the item).

Significant judgements in accounting for the impairment of property, plant and equipment might include:

- assessing whether there is any indication that an item of property, plant and equipment might be impaired; and
- determining the recoverable amount of the property, plant and equipment if there is an indication that the property, plant and equipment might be impaired.

Significant judgements in applying the revaluation model for property, plant and equipment might include:

- assessing the frequency of revaluations; and
- measuring the fair value of property, plant and equipment for which an active market for the identical item does not exist.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs* Accounting Standard is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 17 from the second edition of the Standard are summarised on page 6.

Depreciation of property, plant and equipment

A19 An entity shall prospectively apply the amended requirements in paragraphs 17.21–17.22 from the date of initial application.

...

Bearer plants

A49 An entity is permitted to measure a **bearer plant** at its fair value at the beginning of the earliest period presented and use that fair value as its deemed cost at that date. The entity shall recognise any difference between the previous carrying amount and fair value in opening balance of retained earnings at the beginning of the earliest period presented.

Educational notes

An entity might change its estimate of the useful life of an asset or the depreciation method used because of the changes to paragraphs 17.21–17.22. If the entity makes such a change, it applies the revised estimate of useful life or the new depreciation method from the beginning of the reporting period in which the entity first applies the third edition of the Standard (from the date of initial application).

For bearer plants newly in the scope of Section 17, paragraph A49 permits remeasurement to fair value to determine the deemed cost which will then be used to account for the plants.

For all other changes to Section 17 in the third edition of the Standard, the general requirement in paragraph A2 applies, so the changes are applied retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

When accounting for and reporting property, plant and equipment for periods beginning on or after 1 January 2027, the main differences between the requirements of full IFRS Accounting Standards (see IAS 16 *Property, Plant and Equipment*) and the *IFRS for SMEs* Accounting Standard (see Section 17) are:

- the *IFRS for SMEs* Accounting Standard is drafted in simpler language than that used in full IFRS Accounting Standards.
- IAS 16 requires an annual review of the residual value, useful life and depreciation method. Section 17 requires a review *only* if there is an indication that there has been a significant change since the last annual reporting date.
- IAS 16 states that the revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. Section 17 is silent on this matter.
- IAS 16 requires the items in a class of property, plant and equipment to be revalued simultaneously. Section 17 does not contain such a requirement. However, it requires that revaluations are made with sufficient regularity to ensure that the carrying amount of an asset does not differ materially from fair value at the end of the reporting period.
- full IFRS Accounting Standards require borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of that asset. The *IFRS for SMEs* Accounting Standard requires borrowing costs to be expensed when they are incurred.
- IAS 16 provides guidance on which fair value to use for exchanges of assets. In particular, if an entity can measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident. Section 17 does not specify which fair value to use to measure the cost of the acquired asset.
- full IFRS Accounting Standards require that a non-current asset shall not be depreciated while it is classified as held for sale (IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*). There is no equivalent to IFRS 5 in the *IFRS for SMEs* Accounting Standard, and Section 17 does not require depreciation to cease when there is a plan to dispose of an asset. Therefore, the asset continues to be depreciated.

For differences related to impairment testing see Module 27 *Impairment of Assets*.

This table sets out the disclosure requirements in IAS 16 compared with the disclosure requirements in Section 17. 'X' means a disclosure requirement has no equivalent.

IAS 16 paragraph	Section 17 paragraph
73(a)–(d)	31(a)–(d)
73(e)(i)–(iv), 73(e)(ix)	31(e)(i)–(iv); 31(e)(vi)–(viii)
X	31(e)(v)
73(e)(v)	31(e)(vi)
73(e)(vi)–(vii)	31(e)(vii)–(viii)
73(e)(viii)	X
74(a); 74(c)	32(a)–(b)
X	32(c)
74(b)	X
74A	X
77	33

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 17 by answering the questions provided.

Assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out on page 56.

Mark the box next to the most correct statement.

Question 1

Property, plant and equipment are defined as:

- ☐ (a) tangible assets held for sale in the ordinary course of business.
- ☐ (b) tangible assets held to earn rentals or for capital appreciation or both.
- ☐ (c) tangible assets held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and expected to be used during more than one reporting period.

Question 2

An SME operates a bed and breakfast from a building it owns. The SME also provides its guests with other services including housekeeping, satellite television and broadband internet access. The daily room rental includes these services. Upon request, the SME conducts tours of the surrounding area for its guests. Tour services are charged separately.

The SME should account for the building as:

- ☐ (a) property, plant and equipment.
- ☐ (b) investment property.
- ☐ (c) inventory.

Question 3

If an SME applies the cost model, it measures its property, plant and equipment after initial recognition at:

- ☐ (a) cost.
- ☐ (b) cost minus any accumulated depreciation and any accumulated impairment losses.
- ☐ (c) cost plus the cost of day-to-day servicing, minus any accumulated depreciation and any accumulated impairment losses.
- ☐ (d) cost plus the cost of day-to-day servicing.

Question 4

An SME operates an executive aviation service. The SME's only item of property, plant and equipment is an aeroplane it acquired for CU10,400,000. The cost of the aeroplane is attributed to its significant parts as follows: the jet engine (60%), body (20%), aviation equipment (10%) and furniture and fittings (10%).

A condition of operating an aeroplane is that aviation authorities inspect it every three years. An inspection costs CU400,000. The aeroplane was inspected at the manufacturer's expense before delivery to the SME.

Aviation regulations require the jet engine to be replaced when it has flown two million air miles. Management intends to fit a new engine to the aeroplane when it requires replacement so the aeroplane can be used for approximately 10 years, at which time it intends to scrap the aeroplane.

Management does not expect to replace the body of the aeroplane or the aviation equipment. However, management assesses the useful life of the furniture and fittings to be five years, at which time they will be scrapped and replaced.

The significant parts of the aeroplane that the SME must depreciate separately cost:

- ☐ (a) CU6,240,000 for the jet engine, CU2,080,000 for the body, CU1,040,000 for the aviation equipment and CU1,040,000 for the furniture and fittings.
- ☐ (b) CU10,400,000 for the aeroplane as a whole.
- ☐ (c) CU6,000,000 for the jet engine, CU3,000,000 for the body and equipment, CU1,000,000 for the furniture and fittings and CU400,000 for the aviation inspection.

Question 5

The facts are the same as in Question 4.

What depreciation methods are most appropriate for the SME to apply to compute depreciation for the significant parts of the aeroplane?

- ☐ (a) Straight-line method for all parts of the aeroplane.
- ☐ (b) Units of production method, based on air miles flown, for the jet engines and the straight-line method for all other parts of the aeroplane.
- ☐ (c) Revenue-based method, based on expected ticket sales and future price changes, for the aeroplane as a whole.
- ☐ (d) Units of production method, based on air miles flown, for all parts of the aeroplane.
- ☐ (e) Diminishing balance method for all parts of the aeroplane.

Question 6

A building is held by a subsidiary to earn rentals under an operating lease to its parent. Both the parent and the subsidiary are SMEs. The parent manufactures its products in the rented building. The fair value of the building can be measured reliably without undue cost or effort on an ongoing basis.

The building is:

- ☐ (a) accounted for as property, plant and equipment by the subsidiary and investment property by the group.
- ☐ (b) accounted for as property, plant and equipment by both the subsidiary and the group.
- ☐ (c) accounted for as investment property by both the subsidiary and the group.
- ☐ (d) accounted for as an investment property by the subsidiary and as an item of property, plant and equipment by the group.

Question 7

On 1 January 20X1 an SME acquired a building for CU95,000, including CU5,000 non-refundable purchase taxes. The purchase agreement provided for payment (including payment of the purchase taxes) to be made in full on 31 December 20X1. Legal fees of CU2,000 were incurred in acquiring the building and paid on 1 January 20X1.

The building is occupied by the SME's administrative staff.

An appropriate discount rate is 10% a year.

The SME measures the initial cost of the building at:

- ☐ (a) CU102,000.
- ☐ (b) CU97,000.
- ☐ (c) CU88,364.
- ☐ (d) CU107,000.

Question 8

On 1 January 20X1 an SME acquired land and a building on it for CU300,000 of which CU100,000 was attributable to the building and CU200,000 was attributable to the land. At 31 December 20X1 management assessed:

- the building's useful life as 40 years from the date of acquisition;
- the building's residual value as CU20,000;
- the building's future economic benefits as being expected to be consumed evenly over 40 years from the date of acquisition; and
- the fair value of the building as CU130,000.

The building is occupied by the SME's sales staff.

The SME applies the cost model when accounting for all its property, plant and equipment.

The SME should measure the carrying amount of the building on 31 December 20X1 at:

- ☐ (a) CU100,000.
- ☐ (b) CU98,000.
- ☐ (c) CU130,000.
- ☐ (d) CU127,250.

Question 9

Assume the same facts as in Question 8. On 31 December 20X2 the SME reassessed the property as follows:

- the building's useful life as 60 years from the date of acquisition;
- the building's residual value as CU10,000;
- the building's future economic benefits as expected to be consumed evenly over 60 years from the date of acquisition; and
- the fair value of the building as CU160,000.

The SME applies the cost model when accounting for all its property, plant and equipment.

The SME should measure the carrying amount of the building on 31 December 20X2 at:

- ☐ (a) CU96,508.
- ☐ (b) CU96,000.
- ☐ (c) CU160,000.
- ☐ (d) CU125,263.

Question 10

On 1 January 20X4 an SME purchased a plot of land and began to construct a building on the land for use as its administrative headquarters. The building was completed and administrative staff moved in on 1 January 20X5. On 1 January 20X8 the SME's administrative staff moved out of the building and into newly acquired premises. The building was immediately rented to an independent third party under an operating lease. On 31 December 20X9 the SME accepted an unsolicited offer from the tenant to purchase the building from the SME with immediate effect.

The fair value of the building can be determined reliably without undue cost or effort on an ongoing basis.

The SME should account for the building as:

- ☐ (a) investment property from 1 January 20X4 to the date of disposal (31 December 20X9).
- ☐ (b) property, plant and equipment during the period 20X4–20X9.
- ☐ (c) property, plant and equipment during the period 20X4–20X7 and investment property during the period 20X8–20X9.
- ☐ (d) investment property during 20X4 and the period 20X8–20X9 and as property, plant and equipment during the period 20X5–20X7.

Question 11

If an SME applies the revaluation model, it must measure its property, plant and equipment at:

- ☐ (a) cost minus any accumulated depreciation and any accumulated impairment losses.
- ☐ (b) present value.
- ☐ (c) fair value at the date of the revaluation minus any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Question 12

When an SME applies the revaluation model and an asset's carrying amount is increased because of a revaluation, assuming there was no decrease in carrying amount in previous years, the increase is recognised in:

- ☐ (a) other comprehensive income and accumulated in equity under the heading of retained earnings.
- ☐ (b) profit or loss.
- ☐ (c) retained earnings.
- ☐ (d) other comprehensive income and accumulated in equity under the heading of revaluation surplus.

Question 13

When an SME applies the revaluation model and an asset's carrying amount is decreased because of a revaluation, the decrease is recognised:

- ☐ (a) directly in retained earnings, because it is an unrealised loss.
- ☐ (b) in profit or loss.
- ☐ (c) in other comprehensive income to the extent of any credit balance in the revaluation surplus, in respect of that asset and any excess (over the credit balance) in profit or loss.
- ☐ (d) in other comprehensive income.

Question 14

An SME chooses the revaluation model as its accounting policy for its property, plant and equipment. On 1 January 20X1 the entity acquired a building for CU10,000. Management assessed the useful life as 10 years and residual value as nil. Management also assessed that the SME will consume the building's future economic benefits evenly over 10 years from the date of acquisition.

The fair value of the asset at 31 December 20X1 is CU8,000.

How should the SME recognise the depreciation and the decrease in the asset's carrying amount during the year ended 31 December 20X1?

- ☐ (a) Depreciation of CU1,000 and decrease in carrying amount of CU1,000, both in profit or loss.
- ☐ (b) Depreciation of CU1,000 and decrease in carrying amount of CU1,000, both in retained earnings.
- ☐ (c) Depreciation of CU1,000 and decrease in carrying amount of CU1,000, both in other comprehensive income.
- ☐ (d) Depreciation of CU1,000 in profit or loss and decrease in carrying amount of CU1,000 in other comprehensive income.

Question 15

Which of the following is **NOT** a disclosure requirement for items of property, plant and equipment stated at revalued amounts?

- ☐ (a) The name of the valuer.
- ☐ (b) The effective date of the revaluation.
- ☐ (c) The revaluation surplus indicating the change.
- ☐ (d) The carrying amount that would have been recognised had the assets been carried under the cost model (for each revalued class of property, plant and equipment).

Answers

- Q1 (c)—See paragraph 17.2.
- Q2 (a)—See paragraphs 16.2(a) and 17.2(a). The building forms part of an active business with integrated cash flows, instead of a passive investment.
- Q3 (b)—See paragraph 17.15.
- Q4 (c)—See paragraphs 17.7 and 17.16.

Calculation: cost excluding the cost of the inspection performed before delivery = CU10,000,000.
Allocation: 60% jet engine, 30% body and equipment and 10% furniture and fittings.

- Q5 (b)—See paragraph 17.22.
- Q6 (d)—See paragraphs 16.2 and 17.2.
- Q7 (c)—Calculation: $\text{CU}95,000 \text{ (purchase price including non-refundable taxes)} \div 1.1 = \text{CU}86,364$
present value of the purchase price + CU2,000 direct costs (legal fees) = CU88,364.
- Q8 (b)—Calculation: $\text{CU}100,000 \text{ cost} - \text{CU}2,000 \text{ accumulated depreciation (CU}80,000 \text{ depreciable amount} \div 40 \text{ years' useful life} \times 1 \text{ year in use)} = \text{CU}98,000$.
- Q9 (a)—Calculation:

	CU	
Cost	100,000	
Minus: 20X1 depreciation	2,000	(CU80,000 depreciable amount $\div$ 40 years' useful life $\times$ 1 year in use)
Carrying amount at end of 20X1	<u>98,000</u>	
Minus: 20X2 depreciation	1,492	(CU88,000 remaining depreciable amount $\div$ 59 years' remaining useful life $\times$ 1 year in use)
Carrying amount at end of 20X2	<u><u>96,508</u></u>	

- Q10 (c)—See paragraphs 16.2, 16.9 and 17.2.
- Q11 (c)—See paragraph 17.15B.
- Q12 (d)—See paragraph 17.15C.
- Q13 (c)—See paragraph 17.15D.
- Q14 (a)—See paragraph 17.15D. Calculation: depreciation: $(\text{CU}10,000 - 0) \div 10 \text{ years} = \text{CU}1,000$.
Carrying amount: $\text{CU}10,000 - \text{CU}1,000 = \text{CU}9,000$. Difference between carrying amount (after depreciation) and fair value: $\text{CU}9,000 - \text{CU}8,000 = \text{CU}1,000$.
- Q15 (a)—See paragraph 17.33.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements in Section 17 by completing the case studies provided.

Once you have completed a case study, check your answers against those set out on pages 58, 61 and 66.

Case study 1

SME A incurred (and paid) the following expenditures in acquiring an administration building and the land on which it is built:

<i>Date</i>	<i>CU</i>	<i>Additional information</i>
1 January 20X1	200,000,000	Purchase price; 20% of the price is attributable to the land
1 January 20X1	20,000,000	Non-refundable transfer taxes (not included in the CU200,000,000 purchase price)
1 January 20X1	1,000,000	Legal costs directly attributable to the acquisition
1 January 20X1	10,000	Reimbursing the previous owner for prepaying the non-refundable local government property taxes for the six-month period ending 30 June 20X1
30 June 20X1	20,000	Non-refundable annual local government property taxes for the year ending 30 June 20X2
Throughout 20X1	120,000	Day-to-day repairs and maintenance, including the salary and other costs of the administration and maintenance staff

At 31 December 20X1 SME A made the following assessments:

- the useful life of the building as 50 years from the date of acquisition;
- the residual value of the building as CU20,000,000;
- the fair value of the land and building as CU250,000,000, of which CU54,500,000 represents the land element and CU195,500,000 represents the building element; and
- that the entity will consume the building's future economic benefits evenly over the useful life from the date of acquisition.

Ignoring deferred tax, prepare accounting entries to record the effects of the property, plant and equipment in the accounting records of SME A for the year ended 31 December 20X1. Assume SME A has chosen to use the cost model.

Answer to Case study 1

At 1 January 20X1

Dr	Land (cost)	CU40,000,000 ^(a)	
Dr	Buildings (cost)	CU160,000,000 ^(a)	
	Cr	Cash	CU200,000,000

To recognise the acquisition of the property.

Dr	Land (cost)	CU4,000,000 ^(b)	
Dr	Buildings (cost)	CU16,000,000 ^(b)	
	Cr	Cash	CU20,000,000

To recognise the non-refundable transfer taxes incurred in acquiring the property.

Dr	Land (cost)	CU200,000 ^(c)	
Dr	Buildings (cost)	CU800,000 ^(c)	
	Cr	Cash	CU1,000,000

To recognise legal costs directly attributable to the acquisition of the property.

Dr	Prepaid expenses (asset)	CU10,000	
	Cr	Cash	CU10,000

To recognise local government property taxes prepaid for the six months ending 30 June 20X1.

At 30 June 20X1

Dr	Prepaid expenses (asset)	CU20,000	
	Cr	Cash	CU20,000

To recognise local government property taxes paid on 30 June 20X1 for the 12 months ending 30 June 20X2.

For the year ended 31 December 20X1

Dr	Profit or loss (operating expenses)	CU10,000	
	Cr	Prepaid expenses (asset)	CU10,000

To recognise as an expense local government property taxes prepaid on 1 January 20X1 for the first six months ending 30 June 20X1.

Dr	Profit or loss (operating expenses)	CU10,000	
	Cr	Prepaid expenses (asset)	CU10,000

To recognise local government property taxes paid on 30 June 20X1 for the last six months of the current reporting period. (CU10,000 will remain as an asset as it relates to the first six months of the next reporting period.)

Dr	Profit or loss (operating expenses)	CU120,000	
	Cr	Cash	CU120,000

To recognise day-to-day repairs and maintenance of the building during 20X1.

Dr	Profit or loss (operating expenses)	CU3,136,000 ^(d)	
	Cr	Accumulated depreciation (PPE—buildings)	CU3,136,000

To recognise depreciation of the building during 20X1.

The calculations and notes explain the answer to this case study:

- ^(a) Land element: $20\% \times \text{CU}200,000,000 = \text{CU}40,000,000$
 Building element: $80\% \times \text{CU}200,000,000 = \text{CU}160,000,000$
- ^(b) Land element: $20\% \times \text{CU}20,000,000 = \text{CU}4,000,000$
 Building element: $80\% \times \text{CU}20,000,000 = \text{CU}16,000,000$
- ^(c) Land element: $20\% \times \text{CU}1,000,000 = \text{CU}200,000$
 Building element: $80\% \times \text{CU}1,000,000 = \text{CU}800,000$
- ^(d) $\text{CU}160,000,000^{(a)} + \text{CU}16,000,000^{(b)} + \text{CU}800,000^{(c)} = \text{CU}176,800,000$ cost of buildings
 $(\text{CU}176,800,000 \text{ cost} - \text{CU}20,000,000 \text{ residual value}) \div 50 \text{ years (consumption of future economic benefits evenly over the 50-year useful life of the building)} = \text{CU}3,136,000$ depreciation for the year

Case study 2

Case study 2 is identical to Case study 1 except that SME A has chosen to apply the revaluation model to its land and buildings.

Ignoring deferred tax, prepare accounting entries to record the effects of the property, plant and equipment in the accounting records of SME A for the year ended 31 December 20X1.

Answer to Case study 2

At 1 January 20X1

Dr	Land (cost)	CU40,000,000 ^(a)	
Dr	Buildings (cost)	CU160,000,000 ^(a)	
	Cr	Cash	CU200,000,000

To recognise the acquisition of the property.

Dr	Land (cost)	CU4,000,000 ^(b)	
Dr	Buildings (cost)	CU16,000,000 ^(b)	
	Cr	Cash	CU20,000,000

To recognise the non-refundable transfer taxes incurred in acquiring the property.

Dr	Land (cost)	CU200,000 ^(c)	
Dr	Buildings (cost)	CU800,000 ^(c)	
	Cr	Cash	CU1,000,000

To recognise legal costs directly attributable to the acquisition of the property.

Dr	Prepaid expenses (asset)	CU10,000	
	Cr	Cash	CU10,000

To recognise local government property taxes prepaid for the six months ending 30 June 20X1.

At 30 June 20X1

Dr	Prepaid expenses (asset)	CU20,000	
	Cr	Cash	CU20,000

To recognise local government property taxes paid on 30 June 20X1 for the 12 months ending 30 June 20X2.

For the year ended 31 December 20X1

Dr	Profit or loss (operating expenses)	CU10,000	
	Cr	Prepaid expenses (asset)	CU10,000

To recognise as an expense local government property taxes prepaid on 1 January 20X1 for the first six months ending 30 June 20X1.

Dr	Profit or loss (operating expenses)	CU10,000	
	Cr	Prepaid expenses (asset)	CU10,000

To recognise local government property taxes paid on 30 June 20X1 for the last six months of the current reporting period. (CU10,000 will remain as an asset as it relates to the first six months of the next reporting period.)

Dr	Profit or loss (operating expenses)	CU120,000	
	Cr	Cash	CU120,000

To recognise day-to-day repairs and maintenance of the building during 20X1.

Dr	Profit or loss (operating expenses)	CU3,136,000 ^(d)	
	Cr	Accumulated depreciation (PPE—buildings)	CU3,136,000

To recognise depreciation of building during 20X1.

Dr	Accumulated depreciation (PPE—buildings)	CU3,136,000 ^(e)	
Dr	Buildings (fair value)	CU18,700,000 ^(f)	
Dr	Cost/value of land	CU10,300,000 ^(f)	
	Cr	Other comprehensive income—Revaluation	CU32,136,000 ^(g)

To recognise the fair value of the land and buildings at 31 December 20X1.

The calculations and notes explain the answer to this case study:

^(a) Land element: $20\% \times \text{CU}200,000,000 = \text{CU}40,000,000$

Building element: $80\% \times \text{CU}200,000,000 = \text{CU}160,000,000$.

^(b) Land element: $20\% \times \text{CU}20,000,000 = \text{CU}4,000,000$

Building element: $80\% \times \text{CU}20,000,000 = \text{CU}16,000,000$.

^(c) Land element: $20\% \times \text{CU}1,000,000 = \text{CU}200,000$

Building element: $80\% \times \text{CU}1,000,000 = \text{CU}800,000$.

^(d) $\text{CU}160,000,000^{(a)} + \text{CU}16,000,000^{(b)} + \text{CU}800,000^{(c)} = \text{CU}176,800,000$ cost of buildings.

$[\text{CU}176,800,000 \text{ cost} - \text{CU}20,000,000 \text{ residual value}] \div 50 \text{ years (consumption of future economic benefits evenly over the 50-year useful life of the building)} = \text{CU}3,136,000$ depreciation for the year.

^(e) To revalue the building at 31 December 20X1 at its fair value, one approach would be to reduce the existing balance of accumulated depreciation at the time of revaluation to zero.

^(f)	Cost (CU)	Depreciation (CU)	Carrying amount (CU)	Fair value (CU)	Revaluation increase (CU)
<u>Element</u>					
Land	44,200,000	—	44,200,000	54,500,000	10,300,000
Building	176,800,000	3,136,000	173,664,000	195,500,000	21,836,000

The gross carrying amount of the building is revalued upward by CU18,700,000 (CU21,836,000 – CU3,136,000^(d)).

- ^(g) The CU32,136,000 revaluation increase would be recognised in other comprehensive income for the difference between fair value of CU250,000,000 (CU54,500,000 + CU195,500,000) and carrying amount of CU217,864,000 (CU44,200,000 + CU173,664,000).

The amount recognised in other comprehensive income is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Case study 3

SME B has one item of property, plant and equipment—the office building occupied by its administrative staff and the land on which it is built. At 31 December 20X1 the carrying amount of the property was CU2 million net of CU1 million accumulated depreciation. SME B depreciates the building on the straight-line method over 50 years to a nil residual value.

On 30 June 20X2 SME B acquired all of the equity of SME C. Information about SME C's property, plant and equipment on 30 June 20X2 is summarised in the table.

Description	Remaining useful life	Carrying amount (CU)	Residual value (CU)	Fair value (CU)
Factory building A	10 years	1,000,000	100,000	1,500,000
Factory building B	15 years	6,000,000	1,500,000	9,000,000
Office building A	20 years	4,500,000	2,500,000	7,000,000
Land A (vacant)	Indefinite	300,000	4,000,000	4,000,000
Land B (vacant)	Indefinite	6,000	1,000,000	1,000,000
Land C (vacant)	Indefinite	9,000	2,000,000	2,000,000
Total		11,815,000		24,500,000

SME C intended to develop Land A as a landfill site, to build a new office block on Land B (for its own use) and to build another new office block on Land C.

On 30 September 20X2 in response to an unsolicited offer, SME C disposed of Factory building B for CU9,100,000.

On 1 October 20X2, having reconsidered the office requirements of the group, SME C dropped its plans to build an office block on Land B and subdivided Land B into 30 plots and began to develop residential units on each of the plots, with a view to selling the residential units and the land on which they are built in the ordinary course of business.

On 12 October 20X2 SME C was granted planning permission, at a cost of CU500,000, for the development of an office block on Land C. SME C intends to use the office block for the sales staff of its mail-order operations.

On 1 November 20X2 SME C commenced the operation of a landfill site on Land A. The cost of converting Land A to a landfill site was CU100,000. The landfill site is expected to operate for 10 years before it will be full. Once full, SME C intends to give the site away for free to a developer who will rehabilitate the site (with the developer bearing this cost in full) and then develop the site (with the developer retaining any profits).

On 16 December 20X2 SME C contracted with Entity D (an independent third party) to construct the office block on Land C. The CU10 million fixed-price contract provides for construction to begin by 30 June 20X3 and be completed by 30 June 20X5.

On 30 December 20X2 SME C's Office building A was pledged as security for a CU3million loan from Bank A. The loan was advanced to SME C on 30 December 20X2 and bears interest at the fixed rate of 3% a year. The loan is repayable in full on 31 December 20X8.

At 31 December 20X2 an assessment carried out by the SME B group confirmed the useful lives, residual values and depreciation method applied for all property, plant and equipment. Furthermore, the impairment indicator review found no indication that any item of property, plant and equipment was impaired.

The land on which the buildings are situated is leased under an operating lease.

SME B applies the cost model to its property, plant and equipment.

Draft an extract showing how property, plant and equipment could be presented and disclosed in the consolidated financial statements of SME B for the year ended 31 December 20X2.

Answer to Case study 3

Extract from SME B's consolidated statement of financial position at 31 December 20X2:

Description	Note	20X2	20X1
Property, plant and equipment	14	CU16,789,167	CU2,000,000

Extract from notes to SME B's consolidated financial statements for the year ended 31 December 20X2:

Note 1 Accounting policies

Property, Plant and Equipment

Items of property, plant and equipment are measured at cost minus accumulated depreciation and accumulated impairment losses.

Depreciation is charged to allocate the cost of assets minus their residual values over their estimated useful lives, using the straight-line method. Land, except landfill sites, has an indefinite useful life and is therefore not depreciated. The useful life of buildings is 50 years from the date of construction. The useful life of landfill sites is 10 years from the date of excavation.

Note 3 Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Profit on disposal of property, plant and equipment	(225,000) ^(a)	—
Depreciation	435,833 ^{(o)(i)}	60,000 ^(b)

Note 14 Property, plant and equipment

<i>Description</i>	<i>Landfill site (CU)</i>	<i>Vacant land (CU)</i>	<i>Land and buildings (CU)</i>	<i>Total (CU)</i>
Cost			3,000,000	3,000,000
Accumulated depreciation			(1,000,000)	(1,000,000)
Carrying amount at 31 December 20X1			2,000,000	2,000,000
Acquired in a business combination		7,000,000 ^(d)	17,500,000 ^(e)	24,500,000
Transferred to inventory		(1,000,000) ^(f)		(1,000,000)
Reallocated for change in use	4,000,000	(4,000,000)		
Additions	100,000	500,000 ^(c)		600,000
Disposals			8,875,000 ^(g)	(8,875,000)
Depreciation	(68,333) ^(o)		(367,500) ⁽ⁱ⁾	(435,833)
Carrying amount at 31 December 20X2	4,031,667	2,500,000	10,257,500	16,789,167
Cost	4,100,000	2,500,000 ^(l)	11,500,000 ^(m)	18,100,000
Accumulated depreciation	(68,333) ^(o)		(1,242,500) ⁽ⁿ⁾	(1,310,833)

On 31 December 20X2 the group had contracted with Entity D to construct an office block on vacant land owned by the group. The CU10,000,000 fixed-price contract requires construction to begin by 30 June 20X3 and to be completed by 30 June 20X5. There were no other contractual commitments at 31 December 20X1.

At 31 December 20X2 the group's property, with a carrying amount of CU6,887,500^(p), was pledged as security for a CU3,000,000 loan from Bank A. The loan bears interest at the fixed rate of 3% a year and is repayable in full on 31 December 20X8. The group's remaining property was unencumbered at 31 December 20X1.

continued ...

The calculations and explanatory notes do not form part of the extracts from the financial statements for this case study:

- (a) CU9,100,000 proceeds from the sale of Factory building B minus CU8,875,000^(g) carrying amount = CU225,000 gain on disposal of Factory building B.
- (b) CU3,000,000 cost ÷ 50 years = CU60,000 depreciation a year.
- (c) CU500,000 cost of planning permission for Land C (see paragraph 17.10(b)).
- (d) CU4,000,000 Land A + CU1,000,000 Land B + CU2,000,000 Land C = CU7,000,000. The cost to the group is the land's fair value at the date of acquisition (see paragraph 19.13).
- (e) CU1,500,000 Factory building A + CU9,000,000 Factory building B + CU7,000,000 Office building A = CU17,500,000 buildings. The cost to the group is the land's fair value at the date of acquisition (see paragraph 19.13).
- (f) CU1,000,000 carrying amount of Land B now used for sale in the ordinary course of business (inventory) (see paragraph 13.1).
- (g) CU9,000,000 cost – CU125,000 accumulated depreciation^(h) = CU8,875,000 carrying amount of Factory building B at the date of its disposal.
- (h) (CU9,000,000 cost – CU1,500,000 residual value) ÷ 15 years × (3 ÷ 12 months) = CU125,000 accumulated depreciation on Factory building B at the date of its disposal (from 30 June to 30 September 20X2).
- (i) CU60,000 SME B's property^(b) + CU70,000 Factory building A^(j) + CU125,000 Factory building B^(h) + CU112,500 Office building A^(k) = CU367,500.
- (j) (CU1,500,000 cost – CU100,000 residual value) depreciable amount ÷ 10 years' useful life × (6 ÷ 12 months) = CU70,000.
- (k) (CU7,000,000 cost – CU2,500,000 residual value) depreciable amount ÷ 20 years' useful life × (6 ÷ 12 months) = CU112,500.
- (l) CU2,500,000 Land C.
- (m) CU3,000,000 SME B's property + CU1,500,000 Factory building A + CU7,000,000 Office building A = CU11,500,000 buildings.
- (n) CU1,060,000 SME B's property + CU70,000 Factory building A^(j) + CU112,500 Office building A^(k) = CU1,242,500.
- (o) (CU4,100,000 cost – nil residual value (to be given away)) depreciable amount ÷ 10 years' useful life × (2 ÷ 12 months) = CU68,333.
- (p) CU7,000,000 cost – CU112,500^(k) depreciation = CU6,887,500.

NOTES



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