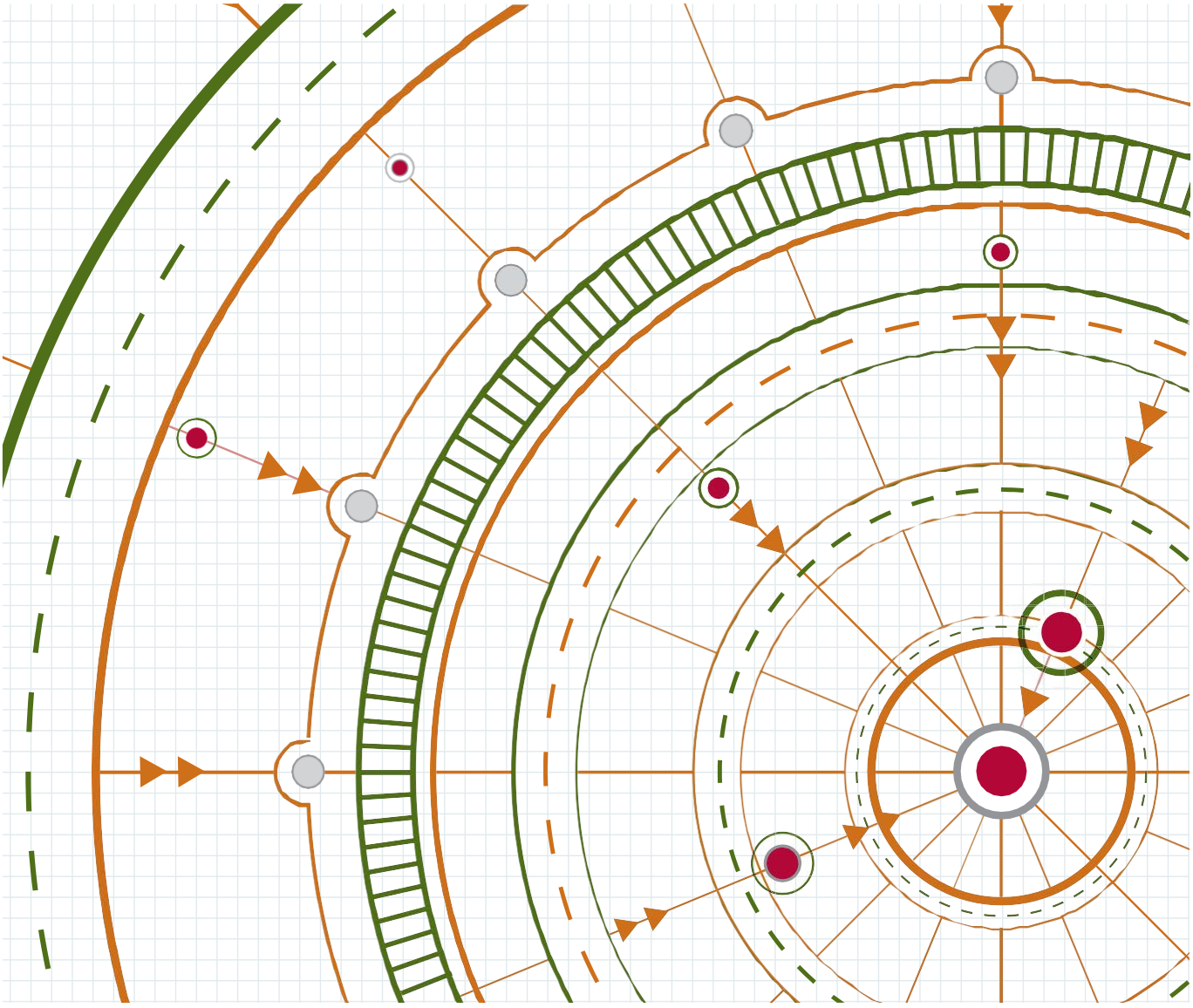
IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 17—Property, Plant and Equipment



IFRS®

IFRS® Foundation Supporting Material for the *IFRS for SMEs*® Standard

including the full text of
Section 17 *Property, Plant and Equipment*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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Module 17—Property, Plant and Equipment

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 17 *Property, Plant and Equipment* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also 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. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs*.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the accounting and reporting of property, plant and equipment applying Section 17 *Property, Plant and Equipment* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in accounting for property, plant and equipment. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provide a practical opportunity to account for property, plant and equipment applying the *IFRS for SMEs* Standard.

Module 17—Property, Plant and Equipment

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- distinguish items of property, plant and equipment from other assets of an entity;
- identify when items of property, plant and equipment qualify for recognition in financial statements;
- measure items of property, plant and equipment on initial recognition and subsequently, both under the cost model and the revaluation model;
- present and disclose property, plant and equipment in financial statements;
- 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
- demonstrate an understanding of the significant judgements that are required in accounting for property, plant and equipment.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (June 2018) the SMEIG has not issued any Q&As relevant to this module.

Module 17—Property, Plant and Equipment

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The objective of Section 17 is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can see information about an entity's investment in its property, plant and equipment and the changes in such investment. 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 them.

The section 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 shall assess whether there is any indication that any item of property, plant and equipment may be impaired (ie carrying amount exceeds 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 included in profit or loss.

What has changed since the 2009 *IFRS for SMEs* Standard

The following are the changes made to Section 17 by the 2015 Amendments:

- alignment of the wording with the amendments to IAS 16 *Property, Plant and Equipment* from *Annual Improvements to IFRSs 2009–2011 Cycle*, issued in May 2012, regarding the classification of spare parts, stand-by equipment and servicing equipment as property, plant and equipment or inventory (see paragraph 17.5).
- addition of the exemption in paragraph 70 of IAS 16 allowing an entity to use the cost of the replacement part as an indication of what the cost of the replaced part was at the time that it was acquired or constructed, if it is not practicable to determine the carrying amount of a part of an item of property, plant and equipment that has been replaced (see paragraph 17.6).
- addition of an option to use the revaluation model (see paragraphs 17.15–17.15D, 17.31(e)(iv) and 17.33).
- consequential changes have also been made to disclosure requirements when an entity has investment property measured using the cost model.

In addition this module reproduces other editorial changes.

Module 17—Property, Plant and Equipment

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.

Ex 1 **An entity (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 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 parent and its subsidiary as a single entity. The consolidated entity uses the building to supply (sell) goods over more than one accounting period.

In the separate financial statements of the 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 applying 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. In the latter case, the parent accounts for the property applying the requirements of Section 17.

7.2 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.

Notes

The *IFRS for SMEs* 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 may (but is not required to) look to the requirements of full IFRS Standards (see paragraph 10.6 of the *IFRS for SMEs* Standard). IAS 40 *Investment Property* specifies that land acquired for an undetermined purpose is classified as investment property (see IAS 40 paragraph 8(b)) because a subsequent decision to use such land as inventory or for development as owner-occupied property would be an investment decision (see the Basis for Conclusions on IAS 40 paragraph B67(b)(ii)).

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*.

Examples—items of property, plant and equipment

Ex 2 **An entity 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 physical asset used in the production of goods that is expected to be used during more than one reporting period.

Ex 3 **An entity 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 entity 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 entity 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 entity enters into an agreement where 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 entity's administrative staff. The ongoing annual rental for the land is nominal.**

The entity will first need to assess whether the nature of the arrangement is in substance a purchase, a finance lease or an operating lease. It may consider the agreement as a whole, or split it into land and building components. The nature of the arrangement will depend on the facts and circumstances of the contract and this is considered in more detail in Module 20 *Leases.* The asset (or assets) will be treated as property, plant and equipment under Section 17 if it is concluded this is a finance lease (possibly with some additional disclosures, as required by Section 20 *Leases*) or an in-substance purchase. 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 entity 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 for rental to others. In addition, the motor vehicles would be classified as

property, plant and equipment rather than as 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*); or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Notes

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

Examples—items not property, plant and equipment

Ex 8 **An entity 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 entity owns a herd of cattle that form the breeding stock of its agricultural activities. The entity 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 in more than one accounting period—they are accounted for as biological assets applying paragraph 34.2. They are outside the scope of Section 17 *Property, Plant and Equipment* (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 entity acquired 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 *Intangible Assets other than Goodwill*).

Recognition

17.4 An entity shall apply the **recognition** criteria in paragraph 2.27 in determining whether to recognise an item of property, plant or equipment. Consequently, the 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**.

Notes

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 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 considerations to the effect of its capitalisation policy. An entity might decide not to capitalise an item that meets the definition of property, plant and equipment if expensing it will not have a material effect on its financial statements (refer module 2) and that decision is not made to intentionally achieve a particular presentation of the entity's financial position, financial performance and cash flows (see paragraph 2.6). Examples of items that may be immaterial include spare parts and tools.

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

Ex 11 **An entity 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 entity is expected to use the servicing equipment for more than one reporting period and therefore it meets the definition of property, plant and equipment in paragraph 17.2.

Ex 12 **An entity manufactures chemicals. It services its manufacturing plant using common tools. Management estimated the useful life of the plant as 3 years and classified it as property, plant and equipment. The entity 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 as they are expected to be used for less than a year. They are classified as inventories.

Ex 13 **A private hospital 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**.

Notes

Paragraph 17.6 draws attention to the fact that paragraph 17.16 requires that major components of an item of property, plant and equipment should be split out if they have different patterns of consumption of economic benefits. This is equally valid when this information only becomes apparent at a later stage through, for example, the unexpected need to replace a component.

Examples—replacement parts

Ex 14 **An entity 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 entity is required to replace the lining immediately. Experience has shown that linings require replacement, on average, every four years. The entity depreciates linings on the straight-line basis over their estimated four-year useful life to a 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[(1)] (CU400,000 cost less CU300,000 accumulated depreciation) was damaged. The lining was immediately replaced at a cost of CU420,000.

To recognise the replacement lining the entity must recognise 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 was removed, the entity must recognise 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 it was not expected to need replacing 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 within 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 previous lining is indicative of expectations for useful life.

When the old lining is removed, the entity 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 (17/20 * 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)'.

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

The entity recognises an asset (property, plant and equipment) of CU20,000 for the inspection. The inspection asset must be recognised as an expense (depreciation) in profit or loss evenly over its estimated two-year useful life (ie CU5,000 expense during the current reporting period). The inspection asset will be depreciated down to nil by the time of the next inspection. Consequently, there would be no amount remaining to derecognise.

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

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 mask the need to depreciate the buildings element of the land and building.

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.

Notes

Costs to produce inventories are covered under Section 13 (refer paragraph 13.5).

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 entity 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. In addition, the entity has to pay CU5,000 in loan raising fees to the Bank. The loan is secured against the equipment.**

In January 20X1 the entity incurred costs of CU20,000 in transporting the equipment to the entity's site and CU100,000 in installing the equipment at the site. At the end of the equipment's 10-year useful life the entity 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 entity's engineer incurred the following costs in modifying the equipment so that it can produce the products manufactured by the entity:

- **Materials – CU55,000**
- **Labour – CU65,000**
- **Depreciation of plant and equipment used to perform the modifications – CU15,000**

In January 20X1 the entity'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**
- **Labour – CU3,000**

In February 20X1 the entity'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**
- **Labour – CU16,000**

The equipment was ready for use on 1 March 20X1. However, because of low initial order levels the entity 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?

Description	*Calculation or reason*	*CU*	*Reference to IFRS for SMEs* Standard
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 cost	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. The equipment was capable of operating in the manner intended by management without incurring the training costs.	-	17.11(c) & 5.4
Cost of testing	CU21,000 materials (ie 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	-	5.4
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 entity acquired a 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 (ie the present value of the future payment).

Calculation: CU2,000,000 future payment x $1/(1.1)^2$.

Note: The unwinding of the discount results in interest expense recognised in profit or loss respectively of CU165,289 and CU181,818 in the first and second 12-month periods after the acquisition. Furthermore, two years after the sale, the liability of CU2,000,000 (ie 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.

Notes

Although the *IFRS for SMEs* 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 Standards do include such guidance.

In the absence of explicit guidance in the *IFRS for SMEs* Standard an entity can, applying paragraph 10.6, consider the requirements and guidance in full IFRS Standards.

In full IFRS Standards (IAS 16 paragraph 25) 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 IAS 16 paragraph 26, 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 entity 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 must the entity 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 at 1 January 20X1.

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

(b) On 1 January 20X1 the entity must recognise 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 all items 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**. Paragraphs 11.27-11.32 provide 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.

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.

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.

The Standard does not require items within a class of property, plant and equipment to be revalued simultaneously. This contrasts with IAS 16 paragraph 38. 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 *IFRS for SMEs* Standard, in common with full IFRS Standards, does not distinguish between categories of reserves, and does not stipulate how transfers between reserves should be affected. In some jurisdictions however, there are legal requirements in regard to 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. Whilst many consider that this provides better information it is not a requirement of the *IFRS for SMEs* Standard. In some jurisdictions the balance in the revaluation surplus may be utilised to fund a bonus/capitalisation issue. Where a bonus issue is funded out of a balance on revaluation surplus or where 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, paragraph 17.15D limits the amount of the decrease that is recognised in other comprehensive income to the lower of (a) the decrease in carrying amount of the asset and (b) the balance at the date of valuation in the revaluation surplus relating to that asset.

Paragraph 17.15C deals with the scenario where there is a decrease in value followed by a subsequent increase in value. 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 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. There is no need to adjust it in the same way that paragraph 17.15D limits the amount recognised in other comprehensive income.

When an asset is revalued downwards below its carrying amount, the asset may or may not also be impaired. When the asset's value in use (see paragraph 27.15) is higher than both the fair value and the asset's previous carrying amount, the asset is not impaired. However, when it is impaired, section 27 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 being revalued, the depreciation charge for the year is still made, ie revaluation does not negate the need to depreciate it.

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

Example—measurement after initial recognition: cost model

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

The entity 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 entity acquired a piece of land for CU500,000. At 31 December 20X1, the land was valued at CU600,000. The entity uses the revaluation model for its land and buildings.**

How must the entity account for the increase in the value of the land for the year ended 31 December 20X1?

Note: Ignore deferred tax

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 OCI is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Revaluation decrease reversing previous revaluation surplus

Ex 22 **The facts are the same as in example 21. At 31 December 20X2, the land was valued at CU300,000. The land is not impaired as its value in use is higher than its fair value.**

How must the entity account for the revaluation of the land for the year ended 31 December 20X2?

Note: Ignore deferred tax

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 reverses the previous revaluation surplus recognised at 31 December 20X1.

(b) Decrease in revaluation at 31 December 20X2 = CU600,000 – CU300,000 = CU300,000.

Excess of deficit over previously recognised revaluation surplus = CU300,000 – CU100,000 = CU200,000.

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

Revaluation surplus reversing previous revaluation decrease

Ex 23 **On 1 January 20X1, an entity acquired a piece of land for CU500,000. At 31 December 20X1, the asset was valued at CU300,000. At 31 December 20X2, the land was valued at CU600,000.**

How must the entity account for the revaluation of the asset for the year ended 31 December 20X1 and 31 December 20X2?

Note: Ignore deferred tax

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) To reverse the revaluation decrease previously recognised in profit or loss i.e CU200,000 (see (a) above) (see paragraph 17.15C).

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

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

Revaluation surplus: effect of depreciation

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

How must the entity account for the revaluation of the building for the year ended 31 December 20X5?

31 December 20X5

Dr	Accumulated depreciation	CU80,000[(a)]	
Dr	Cost/value of Building	CU100,000[(b)]	
	Cr Other comprehensive income – revaluation [(c)]		CU180,000

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

(a) To revalue the building at 31 December 20X5 at its fair value, one approach would be to reduce Accumulated Depreciation to zero.

(b) The buildings' 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 OCI is accumulated in equity under the heading of revaluation surplus (see paragraph 17.15C).

Revaluation surplus reversing previous revaluation decrease: effect of depreciation

Ex 25 **On 1 January 20X1, an entity acquired an office building for CU500,000 with a useful life of 20 years and a nil residual value. At 31 December 20X5, the building has a fair value of CU300,000. The entity uses the revaluation model. At 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 20X10 there has been a significant increase in property prices. At 31 December 20X10, the building was valued at CU400,000.**

How must the entity account for the revaluation of the asset for the year ended 31 December 20X5 and 31 December 20X10?

Note: Ignore deferred tax

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 20X10

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 20X10.

(a) Annual depreciation: CU500,000/20 years = CU25,000
Cumulative depreciation: 20X1 to 20X5 = CU25,000 x 5 years = CU125,000
Carrying amount at 31 December 20X5 = CU500,000 – CU125,000 = CU375,000
Revaluation decrease at 31 December 20X5: CU375,000 – CU300,000 = CU75,000

(b) Annual depreciation: 20X6 to 20X10 = CU300,000/15 years = CU20,000
Cumulative depreciation: 20X6 to 20X10 = CU20,000 x 5 years = CU100,000

(c) Applying paragraph 17.15C, the CU75,000 previously recognised in profit or loss is reversed.

(d) Carrying amount at 31 December 20X10 = CU300,000 – CU100,000 = CU200,000
Revaluation increase at 31 December 20X10 = CU400,000 – CU200,000 = CU200,000
Amount recognised in other comprehensive income at 31 December 20X10 = CU200,000 – CU75,000 = CU125,000

(e) The amount recognised in OCI 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 entity acquired an item of heavy machinery for CU600,000. The machine is made up of three components of equal value: (i) fixed parts—management estimates the fixed parts have a 25-year useful life with no residual value; (ii) moving parts—management estimates the moving parts have a five-year useful life with no residual value; and (iii) a foundation—management estimates the foundation has a 25-year useful life with no residual value. Furthermore, management judges that the straight-line method reflects the pattern in which the entity expects to consume the future economic benefits of all components of the machine.**

What depreciation would the entity determine for 20X1?

The entity must allocate 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 as these components have the same useful life and both must be depreciated using the straight-line 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) + (CU200,000 ÷ 5)).

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*).

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 Section 13 paragraphs 13.8).

Examples—depreciation charge allocated to the cost of an asset

Ex 27 **On 1 January 20X1 an entity acquired a machine for CU1,200,000. Management estimates the machine has a 10-year useful life (measured from the date of acquisition) and a nil residual value. Furthermore, management judges that the straight-line method reflects the pattern in which the entity expects to consume the machine's future economic benefits.**

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 entity.

The entity is accounting for the machine using the cost model.

Depreciation for the year is CU120,000 (calculation: CU1,200,000 ÷ 10 years). In 20X1 the entity allocates CU80,000 (ie 8/12 months x CU120,000) to the cost of inventories manufactured in 20X1 and CU40,000 to the cost of the new plant undergoing construction (ie 4/12 months x CU120,000).

Ex 28 **The facts are the same as example 27 except the entity 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 entity allocates CU80,000 (ie 8/12 months x CU120,000) to the cost of inventories manufactured in 20X1 and CU40,000 to the cost of the new plant undergoing construction (ie 4/12 months x CU120,000).

The revaluation increase recognised in OCI and accumulated in the revaluation surplus in equity is CU220,000 (CU1,300,000 − CU1,080,000). Depreciation in 20X2 is based on the revalued amount of CU1,300,000. Depreciation for 20X2 is CU144,444 (CU1,300,000 / 9 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.

Useful life is defined 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 may be shorter than its economic life. See examples on determining the useful life under 17.21 below.

Paragraph 17.22 sets out how to select a depreciation method to allocate the depreciable amount over the 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 paragraphs 10.15–10.18.

Notes

The depreciable amount of an item of property, plant and equipment is its cost, or other amount substituted for cost (in the financial statements), less its residual value.

The residual value of an item of property, plant and equipment is the estimated amount that an entity would currently obtain from disposal of the item, 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 not the amount that the entity expects it will obtain at the end of the useful life.

Applying paragraph 10.16, an entity shall recognise the effect of a change in an accounting estimate prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) 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 entity acquired a machine for CU500,000. The entity is accounting for the machine using the cost model. Management estimated the useful life of the machine as 20 years and its residual value as nil. Furthermore, management believed that the straight-line method reflects the pattern in which it expects to consume the machine's future economic benefits.**

At the entity's 31 December 20X5 financial year-end, management's assessments 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. Management continues to believe that the straight-line method reflects the pattern in which it expects to consume the machine's future economic benefits.

How must the entity 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) (CU400,000[(b)] less 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 (ie 20X5) and for future periods (ie over the revised remaining useful life) is adjusted.

(b) CU500,000 cost less (4 years × CU25,000[(c)] annual depreciation) = CU400,000 carrying amount at 1 January 20X5 (ie 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—commencing and ceasing depreciation

Ex 30 **On 1 January 20X1 an entity acquired a machine for CU3 million. Management estimated the useful life of the machine as 20 years and its residual value as nil. Furthermore, management believes that the straight-line method reflects the pattern in which it expects to consume the machine's future economic benefits.**

The machine was installed and ready for use as intended by management 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 30 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 entity's management 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 entity 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 risks and rewards of ownership of the machine were also transferred from the entity to the buyer on this date.

When does the entity start to depreciate the machine?

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

When does the entity cease depreciating the machine?

The entity ceases depreciating the machine when the machine is derecognised (ie 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 entity temporarily suspend depreciation of the machine between 1 June and 30 July 20X3?

No, the entity 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 (eg 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.
(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 entity 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 entity sells and replaces its luxury motor vehicle fleet every two years although the vehicles are expected to be economically usable by one or more users for at least another three years.

The useful life of the vehicles to the entity 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 entity* (ie two years).

Ex 32 **An entity 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 entity is three years (ie the period over which the equipment is expected to be available for use by the entity taking account of expected levels of servicing). The fact that regular servicing would extend the life of the equipment to five years is irrelevant when the entity does not expect to undertake regular servicing.

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

The useful life of the equipment to the entity is five years (ie 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 ten years is irrelevant when the entity expects to stop operating the equipment after five years.

Ex 34 **An entity 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 entity is required to return the equipment to the lessor at the end of the lease term.**

The useful life of the equipment to the entity is 13 years—the period over which the equipment is expected to be available for use by the entity taking account of limits imposed by the lease (ie the 13-year lease term). The fact that equipment is expected to be fit for purpose for an additional two years is irrelevant, as the entity 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.

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.

Examples—depreciation method

Ex 35 **An entity 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 entity projects that the output of the machine will reach 1 million litres within four years of its acquisition.**

The unit of production method is probably the most appropriate depreciation method for the entity to apply in depreciating the machine. This method reflects the pattern in which the entity 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 entity 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 it expects to consume the machine's future economic benefits.

Ex 36 **As part of their remuneration package an entity 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 straight-line method is probably the most appropriate depreciation method for the entity to apply in depreciating the executive motor vehicles. This method reflects the pattern in which the entity expects to consume the asset's future economic benefits. Using this method half of the depreciable amount of the vehicle would be included in depreciation expense each year. However, the entity may need to re-consider 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 paragraphs 10.15–10.18.

Example—change in depreciation method

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

How must the entity 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

(a) CU358,196[(b)] x 6% = CU21,492

(b)

Year end	Depreciation per year	Carrying amount at the end of the year
20X1	(500,000) x 8% = 40,000	460,000 (500,000 - 40,000)
20X2	460,000 x 8% = 36,800	423,200 (460,000 – 36,800)
20X3	423,200 x 8% = 33,856	389,344 (423,200 – 33,856)
20X4	389,344 x 8% = 31,148	358,196 (389,344 – 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 destroyed a machine when its carrying amount was CU500,000 (cost CU600,000 less CU100,000 accumulated depreciation). The entity immediately registered a claim with the insurance company of CU700,000 for the replacement cost of the machine. However, the insurance company disputed the claim citing negligence by the entity.**

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

On 15 December the entity utilised the CU700,000 to acquire a replacement machine, which was immediately installed and ready for use.

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

30 September 20X6

Dr	Profit or loss—impairment of machinery	CU500,000	
	Cr Accumulated depreciation and accumulated impairment (machinery)		CU500,000

To record impairment of a machine destroyed by fire.

Dr	Accumulated depreciation and accumulated impairment (machinery)	CU600,000	
	Cr Plant (gross carrying amount)		CU600,000

To record the derecognition of a machine destroyed by fire.

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.

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.

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 entity sold a machine. The purchaser took immediate delivery of the machine.**

The entity must derecognise the machine on 14 December 20X5 when the risks and rewards of ownership of the machine passed to the purchaser, assuming all the other conditions in 23.10 are met (see paragraph 17.29 below).

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

On 30 June 20X6 management gave up hope that market conditions would 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 review and at 31 December 20X5 it would consider whether another impairment test should be performed.

On 30 June 20X6 the entity must derecognise 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 entity sold a machine with a carrying amount of CU20,000 for CU35,000. The purchaser took immediate delivery of the machine.**

The entity must derecognise the machine on 14 December 20X5, when the risks and rewards of ownership passed to the purchaser, assuming all the other conditions in paragraph 23.10 are met (see paragraph 17.29 below). Income (a gain on disposal of equipment) of CU15,000 must be recognised in profit or loss on 14 December 20X5.

Ex 42 **On 31 December 20X4, an entity removed its cardboard-box manufacturing machine from production when the machine's carrying amount was CU12,000. However, expecting that demand for cardboard boxes would increase in the foreseeable future, the entity retained its machine. The entity estimated the machine has a recoverable amount of CU8,000 and that the machine had a remaining useful life of 10 years with a CU5,000 residual value.**

In June 20X6 the government of a jurisdiction in which major cardboard manufacturing competitors operate announced significant subsidies designed to protect the profitability of that jurisdiction's cardboard manufacturing industry. Consequently, on 30 June 20X6 management gave up hope that market conditions would improve to the extent that it could restart the manufacture of cardboard boxes. It therefore sold its cardboard box manufacturing machine as scrap for CU5,000 on 1 July 20X6, when its carrying amount was CU7,550.

On 1 July 20X6 (the date of disposal) the entity must recognise 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).

Notes:

- On 31 December 20X4 the machine was impaired, reducing its carrying amount by CU4,000 to CU8,000. The CU4,000 impairment loss was recognised in profit or loss on 31 December 20X4.
- At each subsequent reporting date (ie on 31 December 20X5, assuming the entity does not prepare interim financial reports), the entity would consider whether a further impairment test should be performed (see Section 27 *Impairment of Assets*).
- 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 (ie CU8,000 carrying amount on 1 January 20X5 less CU5,000 residual value = CU3,000 depreciable amount. CU3,000 ÷ 10 years remaining useful life = CU300 depreciation a year. CU300 × 18/12 months = CU450 depreciation for 18 months).

17.29 In determining the date of disposal of an item, an entity shall apply the criteria in Section 23 *Revenue* for recognising revenue from the sale of goods.Section 20 applies to disposal by a sale and leaseback.

Example—date of disposal

Ex 43 **On 8 August 20X5 an entity sold a machine on credit for CU40,000. The purchaser took immediate delivery of the machine. However, the entity 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 entity in full on 8 September and legal title immediately passed to the purchaser.**

The entity must derecognise the machine on 8 August 20X5. At this date the significant risks and rewards of the machine's ownership passed to the purchaser (see paragraph 23.10(a)). In addition, the sale amount is fixed (CU40,000) and will probably flow to the entity (see paragraph 23.10(c) and (d)). The passive retention of legal title as a means of securing payment does not, in itself, constitute continuing managerial involvement or control (see paragraph 23.10(b)). The seller expects to incur no further costs in respect of the sale transaction (see paragraph 23.10(e)).

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.

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 or equipment that it had carried using the revaluation model, a balance related to that asset may remain in the revaluation surplus at the date of sale.

The *IFRS for SMEs* Standard does not prescribe how, when or if amounts can be transferred between components of equity (see paragraph 2.22 of the *IFRS for SMEs* Standard). These decisions are left to the discretion of preparers, subject to the constraints imposed by Section 2. Section 2 requires that the information presented must be understandable, relevant and reliable. Some entities may 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 may be mandated or prohibited by local legislation.

Examples—gain or loss on derecognition

Ex 44 **On 1 November 20X5 an entity sold an owner-occupied building for CU3.5 million. The building had a carrying amount of CU2 million 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 entity had been accounting for the building using the cost model.**

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

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

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

Ex 45 **The facts are the same as in Example 44 except that the entity 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 entity must recognise a gain on the disposal of the building of CU140,000 in profit or loss.

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

The entity may wish to transfer the balance on its revaluation surplus for this property to its retained earnings reserve or to another reserve. If the entity transferred the balance to retained earnings, the balance on retained earnings would be the same as it would have been had the building 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.

Notes

Applying 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:

(a) land;

(b) land and buildings;

(c) machinery;

(d) boats;

(e) aircraft;

(f) motor vehicles;

(g) furniture and fixtures; and

(h) office equipment.

Example—classes

Ex 46 **An entity 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 — ten 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;**
- **Shop fixtures and fittings in its retail outlets.**

The entity'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 must the entity disclose?

To answer this question one must make a materiality judgement.

A class of assets is defined 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 entity should disclose it separately from property, plant and equipment as required by paragraph 4.2. The entity must apply judgement to determine whether the entity's retail outlets are sufficiently different in nature and use from its office buildings, and thus 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

Ex 47 **An entity, 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)

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Depreciation is charged so as to allocate the cost of the assets less 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

	Vacant land	*Land and buildings*	*Machinery*	*Office equipment*	*Total*
	CU'000	*CU'000*	*CU'000*	*CU'000*	*CU'000*
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 less CU600 accumulated depreciation.

(b) CU10,000 + CU5,000 less CU2,000[(a)] and CU4,133 + CU243 less CU600[(a)]

(c) CU3,000 cost less CU1,800 accumulated depreciation

(d) CU13,000 + CU2,000 + CU4,000 less CU3,000[(c)] and CU3,200 + CU1,700 + CU600 less CU1,800[(c)]

(e) CU1,000 cost less CU700 accumulated depreciation

(f) CU4,400 + CU1,000 + CU2,000 less CU1,000[(f)] 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

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

Note 3 Profit before tax (extract)

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

	20X2	20X1
	CU	CU
Depreciation of property, plant and equipment	4,250,000	4,500,000
Impairment of plant	1,000,000	-
Gain on disposal of property	(50,000)	(400,000)

Note 4 Property, Plant and Equipment (extract)

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 requires 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) the methods and significant assumptions applied in estimating the items' fair values;
(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.

Example—disclosures

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

Note 1 Accounting policies (extract)

Property, plant and equipment

Land and buildings are measured at fair value based on valuations by independent valuers, less subsequent depreciation for buildings. Revaluations are performed at least every three years, unless it is considered necessary to perform them with more regularity to ensure that at the end of the reporting period, the carrying amount does not differ materially from fair value at the end of the reporting period. All other items of property, plant and equipment are measured at cost less 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 so as to allocate the cost or valuation of assets less 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.

If the land and buildings were 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	3,250,000	2,750,000

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	4,000,000	3,000,000

Module 17—Property, Plant and Equipment

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
Furthermore, applying paragraph 8.7, an entity must disclose information about the key assumptions concerning 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 *IFRS for SMEs* 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 it 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 may require judgement.
- In some cases, an entity provides ancillary services, to the occupants of a property it holds and rents out such as security and maintenance. In many cases security and maintenance services will be insignificant and hence the building would be classified as investment property. In other cases, a company may rent out fully furnished offices including a whole range of 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 under Section 17 *Property, Plant and Equipment*. However, there are several examples where it may be difficult to judge whether the services are insignificant.

Where significant judgement is needed to determine whether a property qualifies as investment property 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, after initial recognition an entity measures the investment property at its fair value. Otherwise, investment property is measured after initial recognition using the cost model in Section 17 *Property, Plant and Equipment*. The management of an entity 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. Paragraphs 11.27–11.32 of Section 11 *Basic Financial Instruments* provide guidance on determining fair value and paragraphs 2.14A–2.14D of Section 2 *Concepts and Pervasive Principles* provide guidance on the meaning of undue cost or effort.

To account for and 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 may 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.
- 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 (ie at cost less any accumulated depreciation and any accumulated impairment losses) or applying the revaluation model (ie at fair value less subsequent accumulated depreciation and any subsequent accumulated impairment losses). Significant judgements in accounting for the depreciation of property, plant and equipment may 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, applying 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 property, plant and equipment (or significant part of the item); and
- determining the appropriate depreciation method that reflects the pattern in which the entity expects to consume the property, plant and equipment (or significant part of the item).

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

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

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

- assessing the frequency of revaluations, depending upon the changes in the fair value of the items of property, plant and equipment being revalued; and
- measuring the fair value of property, plant and equipment for which an active market for the identical item does not exist.

Module 17—Property, Plant and Equipment

COMPARISON WITH FULL IFRS STANDARDS

When accounting for and reporting property, plant and equipment for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IAS 16 *Property, Plant and Equipment*) and the *IFRS for SMEs* Standard (see Section 17 *Property, Plant and Equipment*) are:

- The *IFRS for SMEs* Standard is drafted in simpler language than that used in full IFRS Standards.
- Full IFRS Standards require an annual review of the residual value, useful life and depreciation method. The *IFRS for SMEs* Standard requires a review *only* if there is an indication that there has been a significant change since the last annual reporting date.
- Full IFRS Standards state 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. The *IFRS for SMEs* Standard is silent on this.
- Full IFRS Standards require the items within a class of property, plant and equipment to be revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. The *IFRS for SMEs* Standard is silent on this.
- Full IFRS 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* Standard requires borrowing costs to be expensed when they are incurred.
- Full IFRS Standards permit the cost model for bearer plants, a subset of biological assets. However, the *IFRS for SMEs* Standard does not address bearer plants specifically and requires the fair value model for those biological assets for which fair value is readily determinable without undue cost or effort and the cost model for all other biological assets.
- Full IFRS provides guidance on which fair value to use for exchanges of assets. In particular, if an entity is able to 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. The *IFRS for SMEs* Standard does not specify which fair value to use to measure the cost of the acquired asset.
- Full IFRS Standards require that a non-current asset shall not be depreciated while it is classified as held for sale (IFRS 5). There is no equivalent to IFRS 5 in the *IFRS for SMEs* Standard and section 17 does not require depeciation to cease when there is a plan to dispose of an asset. Therefore, the asset continues to be depreciated.
- In May 2014, the Board amended IAS 16 to make it clear that a depreciation method based on revenue generated by an activity that includes the use of an asset is not appropriate. This amendment occurred too late to be considered by the Board as part of the changes made to the *IFRS for SMEs* Standard. Consequently, the *IFRS for SMEs* Standard has no equivalent prohibition.

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

Module 17—Property, Plant and Equipment

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting and reporting property, plant and equipment applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

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

The entity should account for the building as:

☐ (a) property, plant and equipment

☐ (b) investment property

☐ (c) inventory

Question 3

If an entity applies the cost model, it must measure its property, plant and equipment after initial recognition at:

☐ (a) cost.

☐ (b) cost less any accumulated depreciation less any accumulated impairment losses.

☐ (c) cost less any accumulated depreciation less any accumulated impairment losses plus the cost of day-to-day servicing.

☐ (d) cost plus the cost of day-to-day servicing.

Question 4

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

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

Aviation regulations require the jet engine to be replaced when it has flown 2 million air miles. Management intends to fit a new engine to the airplane when it requires replacement so the airplane can be used for approximately 10 years, at which time it intends to scrap the airplane.

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

What is the cost of each of the significant parts of the aircraft that the entity must depreciate separately:

☐ (a) CU6,240,000 jet engine, CU2,080,000 body, CU1,040,000 aviation equipment and CU1,040,000 furniture and fittings.

☐ (b) CU10,400,000 jet aircraft.

☐ (c) CU6,000,000 jet engine, CU3,000,000 body and equipment, CU1,000,000 furniture and fittings and CU400,000 aviation inspection.

Question 5

Facts are the same as in Question 4.

What depreciation methods are most appropriate for the entity to apply to compute depreciation for the significant parts of the aircraft?

☐ (a) straight-line method for all parts of the aircraft.

☐ (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 aircraft.

☐ (c) units of production method, based on air miles flown, for all parts of the aircraft.

☐ (d) diminishing balance method for all parts of the aircraft.

Question 6

A building is held by a subsidiary to earn rentals under an operating lease to its parent. 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 entity 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 entity's administrative staff.

An appropriate discount rate is 10% a year.

The entity should measure 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 entity acquired land and building for CU300,000 of which CU100,000 is attributable to the building and CU200,000 is 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 entity will consume the building's future economic benefits evenly over 40 years from the date of acquisition;
- the fair value of the building at CU130,000.

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

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

The entity 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 entity 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 entity will consume the building's future economic benefits evenly over 60 years from the date of acquisition; and
- the fair value of the building at CU160,000.

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

The entity 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 entity 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 entity'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 entity accepted an unsolicited offer from the tenant to purchase the building from the entity with immediate effect.

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

The entity 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 20X4–20X9.

☐ (c) property, plant and equipment during 20X4–20X7 and investment property during 20X8–20X9.

☐ (d) investment property during 20X4 and 20X8–20X9 and as property, plant and equipment during 20X5–20X7.

Question 11

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

☐ (a) cost less any accumulated depreciation and any accumulated impairment losses.

☐ (b) present value.

☐ (c) fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Question 12

When an entity applies the revaluation model and an asset's carrying amount is increased as a result 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 entity applies the revaluation model and an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised:

☐ (a) directly in retained earnings as this is an unrealised gain.

☐ (b) in profit or loss.

☐ (c) in other comprehensive income to the extent of any credit balance existing 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 entity 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;
- the entity 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 entity 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 in profit or loss and decrease in carrying amount of CU1,000 in other comprehensive income.

☐ (d) depreciation of CU1,000 and decrease in carrying amount of CU1,000 both 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 methods and significant assumptions applied in estimating the items' fair values.

Answers

Q1 (c) see paragraph 17.2.
Q2 (a) reason—forms part of an active business with integrated cash flows, rather than a passive investment (see paragraphs 16.2(a) and 17.2(a)).
Q3 (b) see paragraph 17.15.
Q4 (c) see paragraphs 17.7 and 17.16.
calculation—cost excluding the cost of the inspection performed prior to 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 9.2 and 16.2.
Q7 (c) calculation—(CU95,000 purchase price including non-refundable taxes) ÷ 1.1 = CU86,364 present value of the purchase price + CU2,000 direct costs (legal fees) = CU88,364.
Q8 (b) calculation—CU100,000 cost less (CU80,000 depreciable amount ÷ 40 years' useful life × 1 year in use) accumulated depreciation = CU98,000.
Q9 (a) calculation:

	CU	
Cost	100,000	
Less: 20X1 depreciation	2,000	(CU80,000 depreciable amount ÷ 40 years' useful life × 1 year in use)
Carrying amount at end of 20X1	98,000	
Less: 20X2 depreciation	1,492	(CU88,000 remaining depreciable amount ÷ 59 years' remaining useful life × 1 year in use)
Carrying amount at end of 20X2	96,508	

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) calculation – depreciation: (CU10,000 – 0) ÷ 10 years = CU 1,000. Carrying amount: CU 10,000 – CU 1,000 = CU 9,000. Difference between carrying amount (after depreciation) and fair value: CU 9,000 – CU 8,000 = CU 1,000 (see paragraph 17.15D).
Q15 (a) see paragraph 17.33.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for accounting and reporting property, plant and equipment applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those set out beneath it.

Case study 1

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

Date	*CU*	*Additional information*
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— 50 years from the date of acquisition
- the residual value of the building— CU20,000,000
- the entity will consume the building's future economic benefits evenly over the useful life from the date of acquisition
- fair value of the land and building: CU250,000,000— CU54,500,000 represents the land element and CU195,500,000 represents the building element.

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 the cost model has been elected by SME A.

Note: Ignore deferred tax

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 twelve 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.

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

(a) Land element: 20% x CU200,000,000 = CU40,000,000
Building element: 80% x CU200,000,000 = CU160,000,000

(b) Land element: 20% x CU20,000,000 = CU4,000,000
Building element: 80% x CU20,000,000 = CU16,000,000

(c) Land element: 20% x CU1,000,000 = CU200,000
Building element: 80% x CU1,000,000 = CU800,000

(d) CU160,000,000[a] + CU16,000,000[b] + CU800,000[c] = CU176,800,000 cost of buildings.
[CU176,800,000 cost less CU20,000,000 residual value] ÷ 50 years (consume future economic benefits evenly over the 50-year useful life of the building) = CU3,136,000 depreciation for the year

Case study 2

Case study 2 is identical to case study 1 except that SME A applies the revaluation model on 31 December 20X1.

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.

Note: Ignore deferred tax

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 twelve 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 below explain the answer to this case study:

(a) Land element: 20% x CU200,000,000 = CU40,000,000
Building element: 80% x CU200,000,000 = CU160,000,000

(b) Land element: 20% x CU20,000,000 = CU4,000,000
Building element: 80% x CU20,000,000 = CU16,000,000

(c) Land element: 20% x CU1,000,000 = CU200,000
Building element: 80% x CU1,000,000 = CU800,000

(d) CU160,000,000[a] + CU16,000,000[b] + CU800,000[c] = CU176,800,000 cost of buildings.
[CU176,800,000 cost less CU20,000,000 residual value] ÷ 50 years (consume future economic benefits evenly over the 50-year useful life of the building) = CU3,136,000 depreciation for the year

(e) To revalue the building at 31 December 20X1 at its fair value, one approach would be to reduce 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)
Element					
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 OCI 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 below.

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's plans for Land A and Land C were as set out below. SME C's intention for Land B was to build a new office block on the land for its own use. On 30 June 20X2, when SME B acquired SME C, SME B agreed with these plans.

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, in conjunction with SME B, 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 B's office building A was pledged as security for a CU3 million loan from Bank A. The loan was advanced to SME B 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 buildings are situated is immaterial.

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 less accumulated depreciation and accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less 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

Description	*Landfill site (CU)*	*Vacant land (CU)*	*Land and buildings (CU)*	*Total (CU)*
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 contractual commitments at 31 December 20X1.

At 31 December 20X2 SME B'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 property was unencumbered at 31 December 20X1.

The calculations and explanatory notes below 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 less 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 paragraphs 16.5 and 17.10(b)).

(d) CU4,000,000 Land A + CU1,000,000 Land B + CU2,000,000 Land C = CU7,000,000 (ie cost to the group is fair value at the date of acquisition) (see paragraph 19.14)

(e) CU1,500,000 Factory building A + CU9,000,000 Factory building B + CU7,000,000 Office building A = CU17,500,000 buildings. (Cost to the group is fair value at the date of acquisition—Refer to *IFRS for SMEs* Standard, paragraph 19.14).

(f) CU1,000,000 carrying amount of Land B now used for sale in the ordinary course of business (ie inventory). Refer to *IFRS for SMEs* Standard, paragraph 13.1(a).

(g) CU9,000,000 cost less 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 less 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 less CU100,000 residual value) depreciable amount ÷ 10 years' useful life x 6/12 months = CU70,000.

(k) (CU7,000,000 cost less CU2,500,000 residual value) depreciable amount ÷ 20 years' useful life x 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 less nil residual value (to be given away)) depreciable amount ÷ 10 years' useful life x 2/12 months = CU68,333.

(p) CU7,000,000 cost less CU112,500[(k)] depreciation = CU6,887,500.