

# Distinctive Financial Reporting

FAC3702

# Important information

- Assignments
  - Assignment 1: 7 August 2013
  - Assignment 2: 4 September 2013
  - Assignment 3: 18 September 2013
- Next class: 17 August 2013
- Tutor
  - Engela Wiid
  - [FAC3702EW@gmail.com](mailto:FAC3702EW@gmail.com)
- Additional information
  - <https://sites.google.com/site/fac3702ctn/home>

# Distinctive Financial Reporting

FAC3702

Study unit 1  
Property, Plant & Equipment

# Study unit 1 - Overview

- Objective
- Scope
- Definitions
- Recognition
- Measurement
- Derecognition
- Revaluation
- Disclosure
- Tax

# Objective

- Recognition as assets
- Depreciation
- Impairment
- Determining carrying amount

# Property, plant & equipment

## Definition

- Tangible assets
- Held for
  - Use in production or supply of goods/services,
  - Rental to others
  - Administrative purposes
- Expected to be used > 1 period.

*(Tangible structure to generate income)*

# Definitions

- Cost
  - Amount of cash or cash equivalents paid, and
  - Fair value of other consideration given
  - To acquire asset
  - At time of acquisition or construction.
- Depreciable amount
  - Cost (or other substituted amount)
  - Less: residual value
- Depreciation
  - Systematic allocation
  - Of the depreciable amount of an asset
  - Over the asset's useful life
- Carrying amount
  - Amount at which asset
  - Recognised in statement of financial position
  - After deducting
    - accumulated depreciation &
    - accumulated impairment losses.

# Definitions

- Fair value
  - Amount for which asset could be exchanged between
  - Knowledgeable, willing parties
  - In arm's length transaction
- Residual value
  - Estimated amount
  - Entity currently obtain from disposal of asset
  - After deducting estimated cost of disposal
  - If assets already of age & condition - end of useful life.
- Useful life
  - Period asset is expected to be available for use by entity, or
  - # production/similar units expected to be obtained from asset



# Definitions

- Impairment loss
  - Carrying amount > recoverable amount
- Recoverable amount
  - Higher of:
    - Asset's net selling price (Fair value – costs to sell), or
    - Value in use
- Entity-specific value
  - Present value of cash flows
  - Entity expects to **arise from**
    - Continuing use of asset and
    - Disposal @ end of asset's useful life
  - Entity expects to **incur**
    - When settling liability

# Recognition - asset

- Probable
  - Future
  - economic benefits associated with item
  - Will flow to entity
- Cost can be measured reliably
  - Initial cost
  - Subsequent costs
    - Servicing cost → Repairs & maintenance (P&L)
    - Replacement @ regular intervals
    - Regular major inspections

*Aggregate individually insignificant items BUT account for significant components separately*

# Example

- Skyfall Ltd bought a machine on 1 January 2012 for R 1.6 m
- The machine needs to be inspected every 6 000 hours, i.e. it will have to undergo a major service every 2 years.
- The estimated cost of a major service is R 150 000.
- The helicopter has an estimated useful life of 8 years.

## Required

1. Calculate the depreciation & carrying amount for 2012 & 2013.
2. How would these amounts differ if:
  - Inspection needs to be done after 20 months instead of planned 2 yrs, AND
  - Actual cost of first inspection was R 200 000

# Measurement @ recognition

- PPE that qualifies for recognition as asset → cost
- Cost components
  - Purchase price
    - Incl. import duties & non-refundable tax
    - After deducting discounts & rebates
  - Costs directly attributable → location & condition necessary to operate
    - Initial delivery & handling costs
    - Installation & assembly cost
    - Testing
    - Professional fees
  - Estimate of dismantling, removal and restoration cost
  - NOT
    - Cost of opening new facility, introduction of new product, overheads
- Stops
  - Asset is in location & condition necessary to be capable of operating

# Measurement of cost

- Abnormal credit terms
  - Cost = cash equivalent @ recognition date
  - Total payments – cash equivalent = interest
    - Recognise over period of credit
    - Except if capitalised (FAC3703)
- Exchange of PPE items
  - Cost of acquired asset = fair value of asset given up
  - Fair value of asset given up not reliably measured
    - Fair value of asset acquired.
  - Fair value of neither acquired/disposed asset reliably measured
    - Carrying value of asset given up
  - Exchange transaction lacks commercial substance
    - Carrying value of asset given up
  - “Commercial substance”
    - Consider extent → future cash flows expected to change as result of transaction.

# Subsequent measurement

- Cost or Revaluation model
  - Apply policy to entire class of PPE
- Cost
  - Cost – accumulated depreciation – accumulated impairment losses.
- Revalue assets
  - Only if: Fair value can be measured reliably
    - Generally market-based evidence
  - Carry asset at revalued amount less subsequent accumulated depreciation & impairment losses.
  - Revaluation effectively replace carrying amount of asset @ revaluation date.

# Depreciation

- Each significant PPE item depreciated separately
  - May be grouped
- Recognise in profit/loss
  - Unless included in carrying amount of another asset
- Depreciate even if fair value > carrying amount
  - Provided carrying value > residual value.
- Commence depreciation
  - Asset **available** for use
    - In location and condition necessary to be capable of operating in manner intended by management.
  - Actual use not required.
- Cease depreciation
  - Earlier of:
    - Asset classified as 'held for sale'
    - Asset derecognised

# Depreciation (2)

- Useful life – Factors to consider
  - Expected usage of asset
    - Capacity/physical output
  - Expected physical wear & tear
    - Number of shifts and repairs & maintenance program
  - Technical/commercial obsolescence
    - Changes/improvement in production
    - Changes in market demand
  - Legal or similar limits on use of asset
    - Expiry dates of related leases
- Land & buildings → account separately
  - Land generally unlimited useful life



# Depreciation (3)

- Depreciation methods
  - Straight-line
  - Diminishing balance
  - Units of production

Choose method which reflects expected pattern of consumption best.

## **Class example:**

Cost of equipment	R 500 000
Residual value	R 20 000
Useful life (yrs)	4

# Impairment

- Carrying amount > recoverable amount
- Compensation from 3<sup>rd</sup> parties
  - Include in profit/loss when receivable
  - Can include:
    - Indemnity payments from insurers
    - Government payments, e.g. expropriation
    - Physical replacement of impaired/lost asset
- Account separately
  - Impairment/loss of PPE item
  - Related compensation from 3<sup>rd</sup> party
  - Subsequent purchase/construction of assets

# Revaluation

- First revaluation → change in accounting policy (IAS8)
- Review residual values & estimated useful life every year
- Replacement value (RV)
  - Gross → replacement cost (market value) of similar asset
  - Net → fair market value of similar asset of same age/condition
- Treatment of accumulated depreciation
  - Gross replacement value basis
    - Restate proportionally with changes in gross RV
    - 'New' carrying amount = revalued amount
    - General use: Revalue using an index
  - Net replacement value basis
    - Eliminate against gross carrying amount
    - Net amount = revalued amount
    - General use: Buildings

# Revaluation (2)

- Surplus: Carrying amount ↑
  - Other comprehensive income, equity
  - 'Revaluation surplus'
  - Non-distributable reserve
    - Only used for subsequent write-downs or a capitalisation share issue
  - Can transfer directly to retained earnings if asset is derecognised
- Carrying amount ↓
  - Profit/loss
  - Other comprehensive income to extent of any credit balance in revaluation surplus of that asset

# Derecognition

- When?
  - Disposal
  - No future economic benefits expected to arise from use/disposal
- Gain/loss on derecognition
  - Profit/loss
  - Net disposal proceeds less carrying amount
- Date – when ALL of the following satisfied:
  - Significant risks & rewards of ownership transferred to buyer
  - Not continuous managerial involvement nor effective control over goods sold
  - Amount can be measured reliably
  - Probable economic benefits will flow to enterprise
  - Costs incurred iro transaction can be measured reliably

[IAS18]

# CGT

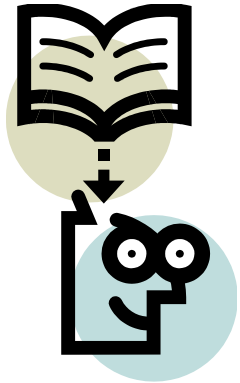
- Capital gain/loss
  - Disposal of asset
    - Sale, donation, loss or destruction
  - Proceeds less base cost
- Base cost
  - Incl: acquisition cost, improvements & costs incurred directly in the acquisition, creation or disposal of the asset
  - Excl: holding costs (interest, repairs & maintenance), recoverable expenses (deductible for income tax) adjustments for inflation.
- Framework – page 38 of Study Guide
  - Inclusion rate for companies – 66%

# Deferred tax [FAC3701]

- Revaluation  $\Rightarrow$  Temporary difference  $\Rightarrow$  Deferred tax
- Carrying value (accounting) and Tax base differs
- Depreciable assets
  
- Non-depreciable assets
  - No decision to sell asset
    - Tax rate (28%) x total revaluation surplus
  - Decision to sell asset
    - Revaluation surplus up to original cost x 28%, and
    - Revaluation surplus excess above base cost at 18.6% (28% x 66.6%)

*[Example 14 & 15]*

# Disclosure – NB!!!!!!



## STUDY

Page 36 & 37 of Study Guide