IFRS Accounting Standards discussion fora: Fixed Assets

2023

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WORLD BANK GROUP

AABE

Accounting and Audit Board of Ethiopia

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Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

Aims

» Develop a more cohesive understanding of IFRS accounting and reporting for fixed assets in Ethiopia.

» Enhance capacity in Ethiopia to apply IFRS Accounting Standards for fixed assets more consistently .

Index of issues

Index of issues

- Classification of fixed assets
  - Issue 1: classification of inalienable freehold land rights
  - Issue 2: classification of latex farmers’ growing rubber trees
  - Issue 3: classification of the dairy herd a manufacturer owns and maintains primarily to provide milk to employees
  - Issue 4: classification of PPE withdrawn from use
  - Issue 5: classification of installed stand-by equipment
  - Issue 6: classification of uninstalled stand-by equipment

Index of issues

- Reclassification of fixed assets
  - Issue 1: reclassification-date measurement of a non-current asset (PPE) that ceases to be held for sale
- Government grants and other forms of government assistance
  - Issue 1: assets granted by the government without price or documents to trace historical cost
  - Issue 2: free from charge land use right received from government
  - Issue 3: import duty waiver

Index of issues

- Historical cost
  - Issue 1: PPE granted free from charge by philanthropist
  - Issue 2: foreign currency exchange rate gains/losses when importing PPE
  - Issue 3: subsequent expenditure on an item of PPE
  - Issue 4: major refurbishment of an item of PPE

Index of issues

» Depreciation

Index of issues

» Revaluation model

» Impairment

Classification of fixed assets

Index of classification issues

» Issue 1: classification of inalienable freehold land rights
» Issue 2: classification of latex farmers' growing rubber trees
» Issue 3: classification of the dairy herd a manufacturer owns and maintains primarily to provide milk to employees
» Issue 4: classification of PPE withdrawn from use
» Issue 5: classification of installed stand-by equipment
» Issue 6: classification of uninstalled stand-by equipment

Issue 1: classification of inalienable freehold land rights

Classification of inalienable freehold land rights
What do you think?

The purpose to which freehold land is put is an important determinant in its IFRS classification.

Which IFRS Accounting Standard applies to inalienable freehold land rights held by the reporting company?

14

Classification of inalienable freehold land rights
Summary of discussion

Which IFRS Accounting Standard applies to inalienable freehold land rights held by the reporting company?

Discussants' consensus view = the purpose to which the reporting company puts its freehold land likely determines its IFRS classification. For example:

» IAS 40 *Investment Property* if land rights put to earning rental income, capital appreciation, or both;

» IAS 16 *Property, Plant and Equipment* if land rights owner-occupied and put to the production of goods, delivery of services, administration etc;

» However, IFRS 5 *Non-current Asset Held for Sale* if the reporting company previously classified the land as investment property or property, plant and equipment and then commits to its sale and is actively marketing it for sale at a price at which it is reasonably expected to sell in the next 12 months (ie satisfies the IFRS 5 reclassification criteria);

» IAS 2 *Inventories* if the reporting company is trading in the land rights.

Issue 2: classification of latex farmers' growing rubber trees

Classification of latex farmers' growing rubber trees planted in the rubber plantation
What do you think?

Latex farming is a relatively new industry in Ethiopia's agriculture sector.

Which IFRS Accounting Standard applies to a latex farmer's living rubber trees planted in the rubber plantation?

Classification of latex farmers' growing rubber trees planted in the rubber plantation
Summary of discussion

Which IFRS Accounting Standard applies to a latex farmer's living rubber trees planted in the rubber plantation?

Discussants' consensus view = growing rubber trees (excluding the harvestable latex contained therein) likely satisfy the definition of bearer plants (IAS 41.5) and consequently likely should be accounted for by the farmer in accordance with IAS 16 *Property, Plant and Equipment.*

» Reasoning: a rubber farmer's living rubber trees are living plants used in the production of latex (agricultural produce) for more than one period, and, provided there is no more than a remote likelihood of the wood from the rubber trees when felled at the end of their useful lives being sold as agricultural produce (except for incidental scrap sales like firewood), satisfy the definition of bearer plants.

Similarly, the IASB observes that rubber trees usually meet the definition of a bearer plant (IAS 41.4).

Issue 3: classification of the dairy herd a manufacturer owns and maintains primarily to provide milk to employees

Classification of a manufacturer's dairy herd
What do you think?

A manufacturer maintains a herd of dairy cows because a law requires that it provides fresh milk to its employees on an ongoing basis.

Which IFRS Accounting Standard applies to the manufacturer's dairy herd?

Classification of a manufacturer's dairy herd
Summary of discussion

Which IFRS Accounting Standard applies to the manufacturer's dairy herd?

Discussants' consensus view = if material the dairy herd must be accounted for in accordance with IAS 41 *Agriculture*.

- Reasoning:
  - cows are biological assets (living animals); and
  - the herd is deployed in agricultural activity (IAS 41.5) because the manufacturer is actively managing the biological transformation of the herd to harvest milk (agricultural produce) from the cows.
- Note:
  - The milk harvested from the cows would be measured at its point-of-harvest fair value less costs to sell. (IAS 41.13)
  - When the milk is distributed to the employees it becomes part of employee benefits (IAS 19 *Employee Benefits*).

Issue 4: classification of PPE withdrawn from use

Classification of PPE withdrawn from use
What do you think?

Many Ethiopian entities (particularly SOEs) purport to have PPE withdrawn from operations for long time because of old age but with material value if sold.

Which IFRS Accounting Standard applies to PPE withdrawn from use?

Classification of PPE withdrawn from use
Summary of discussion

Which IFRS Accounting Standard applies to the PPE withdrawn from use? Discussants' consensus view = it depends:

- IAS 16 *Property, Plant and Equipment* applies until either the criteria for reclassification (for example, to IFRS 5) or the criteria for derecognition are met.
  - Derecognition of an item of PPE occurs at the earlier of disposal or when no future economic benefits are expected from its use or disposal (IAS 16.67).
  - Because idle assets indicate impairment, the entity must test such idle item of PPE for impairment (IAS 36.12).
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* applies only when the criteria to be classified as held for sale are satisfied. Those criteria include actively marketing the asset for sale at a price that is reasonable in relation to its current fair value in accordance with a plan that commits the entity to selling the asset and the sale is expected to be completed typically within 1 year from the date of classification as held for sale (IFRS 5.6–.8).

Issue 5: classification of installed stand-by equipment

Classification of installed stand-by equipment
What do you think?

A manufacturer installs a new generator (generator 2) to generate electricity to operate the factory in the expectedly infrequent event that both the Ethiopian electricity grid and the back-up generator (generator 1) simultaneously fail to deliver electricity to the factory.

Which IFRS Accounting Standard applies to installed stand-by equipment 'generator 1'?

Which IFRS Accounting Standard applies to installed stand-by equipment 'generator 2'?

Classification of installed stand-by equipment
Summary of discussion

Which IFRS Accounting Standard applies to installed stand-by equipment 'generator 1'? Discussants' consensus view = IAS 16 *Property, Plant and Equipment* because generator 1 is a tangible item held for use in the production of goods that is expected to be used in more than one accounting period, albeit irregularly (IAS 16.6 and .8).

Which IFRS Accounting Standard applies to installed stand-by equipment 'generator 2'? Discussants' consensus view = IAS 16 because generator 2 is a tangible item held for use in the production of goods that is expected to be used in more than one accounting period, albeit rarely (IAS 16.6 and .8).

Issue 6: classification of uninstalled stand-by equipment

Classification of uninstalled stand-by equipment
What do you think?

A manufacturer holds in its storeroom a new generator (generator 3) to replace either back-up generators (generator 1 or generator 2) when either are scrapped because they can no longer be depended on to generate electricity when needed (for example, when the Ethiopian electricity grid fails).

Which IFRS Accounting Standard applies to the uninstalled stand-by equipment 'generator 3'?

Classification of uninstalled stand-by equipment
Summary of discussion

Which IFRS Accounting Standard applies to uninstalled stand-by equipment 'generator 3'?

Discussants' consensus view = IAS 16 *Property, Plant and Equipment* because generator 3 is a tangible item held for use in the production of goods that is expected to be used in more than one accounting period, albeit not yet installed and ready for use (IAS 16.6 and .8).

Reclassification of fixed assets

Index of reclassification issues

» Issue 1: reclassification-date measurement of a non-current asset (PPE) that ceases to be classified as held for sale

Issue 1: reclassification-date measurement of a non-current asset (PPE) that ceases to be held for sale

Accounting for the reclassification of a non-current asset when it ceases to be held for sale

What do you think?

Because different IFRS Accounting Standards specify different accounting models, Standards typically also specify how to account for a change in classification of an item (ie reclassification).

Circumstances change such that an item of PPE ceases to satisfy the criteria specified in IFRS 5 for classification as a non-current asset held for sale.

Accounting for the reclassification of a non-current asset when it ceases to be held for sale
Summary of discussion

How to account for the reclassification of a non-current asset (PPE) when it ceases to satisfy the held for sale criteria specified in IFRS 5?

Discussants' consensus view:

» At the reclassification date, measure a non-current asset at the lower of: (i) what carrying amount would have been if it had never been classified as held for sale; and (ii) its reclassification-date recoverable amount (greater of fair value less costs to dispose and value in use) (IFRS 5.27).

» Include any required adjustment in profit or loss from continuing operations (IFRS 5.28).

» The results of operations of the component previously presented in discontinued operations must be reclassified and included in income from continuing operations for all periods presented (ie amounts for prior periods must be described as having been "re-presented". (IFRS 5.36)

Government grants and other forms of government assistance

Index of government grants and assistance issues

» Issue 1: assets granted by the government without price or documents to trace historical cost

» Issue 2: free from charge land use right received from government

» Issue 3: import duty waiver

Issue 1: PPE granted by the government without price or documents to trace historical cost

Free from charge PPE received from government
What do you think?

Government grants the reporting entity full legal ownership of an item of PPE free from charge.

How to account for the item of PPE granted by the government free from charge?

Free from charge PPE received from government
Summary of discussion

How to account for the item of PPE granted by the government free from charge? Discussants' consensus view:

- This likely is a government grant. However, IAS 20 allows the receiving company to account for the grant (and the associated item of PPE) at a nominal value, for example, ETB1. Electing to use this accounting alternative for the government grant obviates the need to determine the fair value of the grant received and the timing of the release to income of the resulting liability (deferred income).
  - Alternatively, in accordance with IAS 20, at initial recognition measure the grant liability (deferred income) and the PPE asset at fair value. Subsequently, release the grant liability to profit or loss to match the expenses the grant was designed to compensate the grant recipient for. Account for the item of PPE in accordance with IAS 16 *Property, Plant and Equipment*.
- However, State-owned Enterprises (SOEs) should consider whether the PPE granted by the government is a capital contribution from the company's owner, rather than a government grant in the scope of IAS 20. Such capital contributions should be measured at fair value.

Issue 2: free from charge land use right received from government

Free from charge land use right received from government
What do you think?

Government grants some companies land use rights **free from charge**.

Should the land use right benefit provided by the government be accounted as a government grant in accordance with IAS 20?

Free from charge land use right received from government
Summary of discussion

Should the land use right benefit provided by the government be accounted as a government grant in accordance with IAS 20? Discussants' consensus view:

» This likely is a government grant. However, IAS 20 allows the receiving company to account for the grant (and the associated land use right) at a nominal value, for example, ETB1. Electing to use this accounting alternative for the government grant obviates the need to determine the fair value of the grant received and the timing of the release to income of the resulting liability (deferred income).

  » Alternatively, in accordance with IAS 20, at initial recognition measure the grant liability (deferred income) and the land use right asset at fair value. Subsequently, release the grant liability to profit or loss to match the expenses the grant was designed to compensate the grant recipient for. If the land use right otherwise satisfies the definition of PPE, account for it in accordance with IAS 16 *Property, Plant and Equipment*.

» However, State-owned Enterprises (SOEs) should consider whether the land use right granted by the government is a capital contribution from the company's owner, rather than a government grant in the scope of IAS 20. Such capital contributions should be measured at fair value.

Issue 3: import duty waiver

Import duty waiver
What do you think?

Government allows some companies to import particular items (materials and machines, including motor vehicles) **duty free**.

Should the duty-free benefit provided by the government be accounted as a government grant in accordance with IAS 20?

45

Import duty waiver
Summary of discussion

Should the duty-free benefit provided by the government be accounted as government grant in accordance with IAS 20?

Discussants' consensus view = no, it is not a government grant. However, it likely is government assistance that must be disclosed.

Note: PwC conclude, albeit in the context of business rates reliefs during the covid pandemic, "The charge will not be levied so there is simply no expense to recognise. There is no transfer of resources so the relief will not be a government grant, but it will represent a form of government assistance for disclosure purposes."
Source www.pwc.co.uk/covid-19/accounting-for-government-assistance-in-response-to-covid-19-pandemic.pdf.

46

Historical cost

Index of historical cost issues

» Issue 1: PPE granted free from charge by philanthropist

» Issue 2: foreign currency exchange rate gains/losses when importing PPE

» Issue 3: subsequent expenditure on an item of PPE

» Issue 4: major refurbishment of an item of PPE

Issue 1: PPE granted free from charge by philanthropist

49

Free from charge PPE received from philanthropist
What do you think?

IAS 20 specifies accounting for government grants.

An entity receives an item of PPE free from charge from a philanthropist.

How to account for an item of PPE granted by a philanthropist free from charge?

Free from charge PPE received from philanthropist
Summary of discussion

How to account for the item of PPE granted by the philanthropist free from charge?
Discussants' consensus view:

- Because no IFRS Accounting Standard explicitly specifies accounting for grants from philanthropists, the reporting entity must determine and apply its accounting policy for grants from philanthropists in accordance with paragraphs 10–12 of IAS 8 (sometimes called the IAS 8 hierarchy).
- Applying the IAS 8 hierarchy likely results in using the accounting specified for government grants in IAS 20, because its likely concluded to be similar and related.
- Applying IAS 20 accounting, by analogy, allows the receiving company to account for the grant (and the associated item of PPE) at a nominal value, for example, ETB1. Electing to use this accounting alternative for the grant obviates the need to determine the fair value of the grant received and the timing of the release to income of the resulting liability (deferred income).
  - Alternatively, in accordance with IAS 20, at initial recognition measure the grant liability (deferred income) and the PPE asset at fair value. Subsequently, release the grant liability to profit or loss to match the expenses the grant was designed to compensate the grant recipient for. Account for the item of PPE in accordance with IAS 16 *Property, Plant and Equipment*.

Issue 2: foreign currency exchange rate gain/loss when importing PPE

Foreign currency exchange rate gains/losses on imported PPE
What do you think?

The cost of an item is the directly attributable amount paid or the fair value of consideration given to acquire the item (IAS 16.6 and .16(b)) that is recognised as an asset because future economic benefits are expected from it and its cost is reliably measurable (IAS 16.7).

How to account for Foreign currency exchange rate gains/losses when importing PPE?

53

Foreign currency exchange rate gains/losses on imported PPE
Summary of discussion

How to account for Foreign currency exchange rate gains/losses when importing PPE? Discussants' consensus view—IFRIC 22 specifies use of the exchange rate on the date on which an entity initially recognises the non-monetary asset arising from the payment of advance consideration. (IFRIC 22.8) For example, a machine is purchased for $10 million. Spot exchange rate = ETB55:$1 when control of the machine passes to reporting entity.

» **Scenario 1:** payment of ETB550 million ($10 million) is made when control over the machine passes to the reporting entity. Historical cost of PPE = ETB550 million.

» **Scenario 2:** payment of ETB540 million ($10 million) is made some months in advance of control over the machine passing to the reporting entity. Historical cost of PPE = ETB540 million (ie using exchange rate on the date the non-monetary asset—right to receive machine—arises in exchange for the payment of advance consideration).

» **Scenario 3:** payment of ETB560 million ($10 million) is made a few months after control over the machine passed to the reporting entity. Historical cost of PPE = ETB550 million. (Note: ETB10 million exchange loss is a currency exchange expense on foreign creditor monetary liability.)

54

Issue 3: subsequent expenditure on an item of PPE

Subsequent expenditure
What do you think?

The cost of an item is the directly attributable amount paid or the fair value of consideration given to acquire the item (IAS 16.6 and .16(b)) that is recognised as an asset because future economic benefits are expected from it and its cost is reliably measurable (IAS 16.7).

How to account for expenditure on an item of PPE that is incurred after it is in the location and condition ready to operate as intended by management?

Accounting for subsequent expenditure on PPE
Summary of discussion

How to account for expenditure on an item of PPE that is incurred after it is in the location and condition ready to operate as intended by management? Discussants' consensus view:

- If the subsequent expenditure incurred takes the form of replacement of a significant component of an item, or otherwise significantly enhances the performance of the item, and the costs incurred can be measured reliably:
  - the costs incurred are capitalized to the item of PPE (IAS 16.7); and
  - the carrying amount of any replaced component is derecognised (IAS 16.13).
- However, the costs of day-to-day servicing (repairs and maintenance) must not be capitalised to the carrying amount of the asset, ie they are expensed as and when incurred (IAS 16.12)

57

Issue 4: major refurbishment of an item of PPE

Accounting for a major refurbishment of an item of PPE
What do you think?

The cost of an item is the directly attributable amount paid or the fair value of consideration given to acquire the item (IAS 16.6 and .16(b)) that is recognised as an asset because future economic benefits are expected from it and its cost is reliably measurable (IAS 16.7).

How to account for a major refurbishment of an item of PPE that is incurred many years after it has been used?

59

Accounting for a major refurbishment of an item of PPE
Summary of discussion

How to account for expenditure incurred in a major refurbishment of an item of PPE? Discussants' consensus view:

- If the subsequent expenditure incurred takes the form of replacement of a significant component of an item, or otherwise significantly enhances the performance of the item, and the costs incurred can be measured reliably:
  - the costs incurred are capitalized to the item of PPE (IAS 16.7); and
  - the carrying amount of any replaced component is derecognised (IAS 16.13).
- Being a major refurbishment, the expenditures incurred are unlikely to be considered day-to-day servicing (repairs and maintenance) that would not be capitalised to the carrying amount of the asset (IAS 16.12).
- Note: such major refurbishment would trigger reassessment of the item's depreciation estimates (for example, useful life and residual value).

60

Depreciation

61

Index of depreciation issues

» Issue 1: depreciation method/s for different classes of assets
» Issue 2: depreciation method/s for items within a class of PPE
» Issue 3: depreciation method/s for components of an item of PPE
» Issue 4: how to depreciate rubber tree bearer plants
» Issue 5: when to start depreciating an item held in storeroom
» Issue 6: accounting for change in the estimated useful life of an item of PPE
Issue 7: accounting for a change in depreciation method
» Issue 8: fully depreciated in-use items of PPE
» Issue 9: fully depreciated in-use items of PPE
» Issue 10: temporarily idle machinery
» Issue 11: building under construction generating rental income

62

Depreciation estimates
What do you think?

Depreciation principle: reflect the item's service potential consumption pattern. (IAS 16.46) In other words, depreciation is "the systematic allocation of the depreciable amount of an asset over its useful life." (IAS 16.6)

However, IAS 38 *Intangible Assets* specifies some rules that override the depreciation principle when amortising intangible assets.

To faithfully reflect the item's service potential consumption, measuring depreciation involves **judgements and estimates** including: (i) identifying depreciation **components**; (ii) determining **depreciation method**; (iii) determining when to **start/stop** depreciating; (iv) estimating **useful live**; and (v) estimating **residual value**.

Issue 1: depreciation method/s for different classes of assets

Depreciation method/s for different classes of assets
What do you think?

An entity has multiple classes of PPE. The service potential consumption pattern of some classes of items is different from others.

Can different depreciation methods be used to depreciate different classes of PPE?

Depreciation method/s for different classes of assets
Summary of discussion

Can different depreciation methods be used to depreciate different classes of PPE?

Discussants' consensus view:

» Yes, because the depreciation method used for an asset classified as PPE <u>must</u> reflect the pattern in which the asset's service potential is expected to be consumed by the entity (IAS 16.60 and .62).

» Consequently, when the service potential of different classes of PPE are consumed in a different pattern, different depreciation method must necessarily be used for the different classes of assets.

» Similarly, different depreciation methods should not be used for classes of items the service potential of which are expected to be consumed in the same pattern.

Issue 2: depreciation method/s for items within a class of PPE

67

Depreciation method/s for items within a class of PPE
What do you think?

An entity has multiple items of PPE in the same class. The service potential consumption pattern of some of items is different from others.

Can different depreciation methods be used to depreciate different items in a class of PPE?

68

68

Depreciation method/s for items within a class of PPE
Summary of discussion

Can different depreciation methods be used to depreciate different items in a class of PPE?

Discussants' consensus view:

» Yes, because the depreciation method used for an asset classified as PPE <u>must</u> reflect the pattern in which the asset's service potential is expected to be consumed by the entity (IAS 16.60).

» Consequently, when the service potential of an item of PPE is consumed in a pattern that is different from other items of PPE in that class, more than one depreciation method must necessarily be used to faithfully reflect the service potential consumption of the items within that class of PPE.

69

Issue 3: depreciation method/s for components of an item of PPE

Depreciation method/s for components of an item of PPE
What do you think?

An entity has an item of PPE which includes a significant component, the service potential consumption pattern of which is significantly different from its other components.

Can different depreciation methods be used to depreciate different components of an item of PPE?

71

71

Depreciation method/s for components of an item of PPE
Summary of discussion

Can different depreciation methods be used to depreciate different components of an item of PPE? Discussants' consensus view:

» Yes, because the depreciation method used for a component of an item of PPE that is significant in relation to the total cost of the item, must reflect the pattern in which the component's service potential is expected to be consumed by the entity (IAS 16.43-.47).

» Consequently, when the service potential of a significant component of an item of PPE is consumed in a pattern that is different from other significant components of the item of PPE, more than one depreciation method must necessarily be used to faithfully reflect the service potential consumption of the items within that class of PPE.

» However, for the avoidance of doubt, when a significant component of an item of PPE has a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item, such parts may be grouped in determining the depreciation charge. (IAS 16.45). Moreover, parts of an item of PPE that have a cost that is not significant in relation to the total cost of the item need not be depreciated separately. (IAS 16.47)

72

72

Issue 4: how to depreciate rubber tree bearer plants

How to depreciate rubber tree bearer plants
What do you think?

Latex farming is a relatively new industry in Ethiopia's agriculture sector.

How should a latex farmer depreciate rubber tree bearer plants?

How to depreciate rubber tree bearer plants
Summary of discussion

How should a latex farmer depreciate rubber tree bearer plants?

Discussants' consensus view:

» Because, from the latex farmer's perspective, the service potential of a rubber tree is to produce harvestable latex, the depreciation method that likely most closely reflects how the latex farmer consumes the tree's service potential is the units of production method, on the basis of the expected harvestable latex yield over the tree's useful life (IAS 16.60).

» Because the expected latex yield is not uniform over time (ie is significantly uneven), other depreciation methods, for example straight-line, are unlikely to reflect the pattern in which the tree's future economic benefits are expected to be consumed by the latex farmer.

Issue 5: when to start depreciating an item held in storeroom

When to start depreciating an item
What do you think?

When is the appropriate time to commence depreciation?

Does depreciation start when the item is in store, ie before usage?

When to start depreciating an item
Summary of discussion

When is the appropriate time to commence depreciation?

Discussants' consensus view:

» Depreciation "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." (IAS 16.55).

Does depreciation start when the item is in store, ie before usage?

Discussants' consensus view:

» It depends, for example:
  » If the units of production method applies, and the service units are not consumed whilst idle in the store, then there is no depreciation.
  » If the time basis (straight-line) depreciation method applies, and the service potential diminishes whilst the item is in the store, for example, a time-based use right), then depreciation starts whilst the item is in store.

Issue 6: accounting for change in the estimated useful life of an item of PPE

Accounting for change in the estimated useful life of an item of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is expected that entities will disclose changes in their depreciation estimates when they occur (IAS 16.76).

How to account for a change in the useful life of an item of PPE?

Accounting for change in the estimated useful life of an item of PPE

Summary of discussion

How to account for a change in the useful life of an item of PPE?

Discussants' consensus view:

- Depreciation estimates (depreciation method, useful life, residual value etc) must be reviewed at least annually (at year-end) (IAS 16.51 and .61)
- Material changes in such estimates, if not the correction of a prior period error, must be accounted for as a change in an accounting estimate, ie prospectively—in the period of the change and future periods (IAS 8.38(b)). For example:
  - An items that cost ETB10 billion on 01/01/2022 is depreciated straight-line over 10 years to nil residual value in 2022 (ie at 31/12/2022 carrying amount = ETB 9 million).
  - In 2023, in response to new information, estimated useful life changes to 13 years (measured from 01/01/2022).
  - Consequently, in accordance with IAS 8 accounting for the change of accounting estimate, depreciation for 2023 = ETB750,000 (ie ETB9 million/12 years); and carrying amount at 31/12/2023 = ETB8.25 million.

Issue 7: accounting for a change in depreciation method

Accounting for a change in depreciation method
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is expected that entities will disclose changes in their depreciation estimates when they occur (IAS 16.76).

How to account for a change in the depreciation method applied to an item of PPE?

Accounting for a change in depreciation method
Summary of discussion

How to account for a change in the depreciation method used for an item of PPE?

Discussants' consensus view:

» Depreciation estimates (depreciation method, useful life, residual value etc) must be reviewed at least annually (at year-end) (IAS 16.51 and .61)

» Material changes in such estimates, if not the correction of a prior period error, must be accounted for as a change in an accounting estimate, ie prospectively—in the period of the change and future periods (IAS 8.38(b)).

Issue 8: fully depreciated in-use items of PPE

Fully depreciated in-use items of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is difficult to envisage how in-use items of PPE could become fully depreciated.

How to account for a fully depreciated in-use item of PPE?

Fully depreciated in-use items of PPE
Summary of discussion

How to account for fully depreciated in-use items of PPE?

Discussants' consensus view:

» Depreciation estimates (depreciation method, useful life, residual value etc) must be reviewed at least annually (at year-end) (IAS 16.51 and .61)

» Consequently, it is difficult to envisage how an in-use item of PPE could become fully depreciated. Therefore, one should consider whether a prior period error has occurred in the accounting for the depreciation of the item.

» If a **material** prior period error is identified, the error must be corrected by retrospective restatement of the comparative amounts for the prior period/s (IAS 8.42).

Issue 9: fully depreciated in-use items of PPE

Fully depreciated in-use items of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is difficult to envisage how in-use items of PPE could become fully depreciated.

Can one 'fix' the accounting for fully depreciated items of PPE by accounting for the fix as a change of accounting policy from the cost model to the revaluation for PPE?

Fully depreciated in-use items of PPE
Summary of discussion

Can one 'fix' the accounting for fully depreciated items of PPE by accounting for the fix as a change of accounting policy from the cost model to the revaluation for PPE? Discussants' consensus view:

- No, although one can voluntarily change a class of PPE from the cost model to the revaluation model (IAS 8.14(b)), one would first need to correct the prior period error by retrospective restatement of the comparative amounts for the prior period/s (IAS 8.42).
- After accounting for the correction of the prior period error, the change in accounting policy from the cost model to the revaluation model would be accounted for as a revaluation in the current reporting period (in accordance with the rule specified in IAS 8.17).

Issue 10: temporarily idle machinery

Temporarily idle machinery
What do you think?

Depreciation must reflect the item's service potential consumption pattern. (IAS 16.46) In other words, depreciation is "the systematic allocation of the depreciable amount of an asset over its useful life." (IAS 16.6)

Does a manufacturer suspend depreciation of a machine whilst it is temporarily idle due to a shortage of raw materials?

92

Temporarily idle machinery
Summary of discussion

Does a manufacturer suspend depreciation of a machine whilst it is temporarily idle due to a shortage of raw materials?

Discussants' consensus view:

- It depends, for example (IAS 16.55):
  - If the units of production method applies, and the service units are not consumed whilst the machine is idle, then there is no depreciation whilst idle.
  - If the time basis (straight-line) depreciation method applies, and the service potential diminishes with the passage of time whilst the item is idle, (for example, a time-based use right), then depreciation continues whilst the machine is idle.

  (Note: idle machinery likely triggers impairment testing accordance with IAS 36 *Impairment of Assets.*)

93

93

Issue 11: building under construction generating rental income

94

Building under construction generating rental income
What do you think?

Depreciation must reflect the item's service potential consumption pattern. (IAS 16.46) In other words, depreciation is "the systematic allocation of the depreciable amount of an asset over its useful life." (IAS 16.6)

Does the owner-lessor depreciate a building whilst it is under construction and is generating rental income?

95

Building under construction generating rental income
Summary of discussion

Does the owner-lessor depreciate a building whilst it is under construction and is generating rental income? Discussants' consensus view = it depends:

- If the owner-lessor determines that the building is investment property and uses the **fair value model** to account for its investment property, the building would not be depreciated.
- If the owner-lessor determines that the building is PPE (or investment property and uses the **cost model** to account for its investment property):
  - the part of the building being rented out would be depreciated if it is ready to operate as intended by management (for example, the construction of the floor of the building being rented out is complete and the higher floors of the building are still being constructed).
  - the part of the building being rented out would not be depreciated if the rental is in respect of **incidental operations** that are not necessary to bring the asset to a condition necessary for it to be capable of operating in the manner intended by management (for example, through renting out the building site basement as a storeroom before and whilst the building is being constructed in accordance with a plan to complete the development of the building including its basement into upmarket retail space). (IAS 40.56(c) and IAS16.22)

96

Revaluation model

Index of revaluation model issues

- Issue 1: voluntary change from cost model to revaluation model
- Issue 2: frequency of revaluation
- Issue 3: revaluation of intangible assets
- Issue 4: accounting for revaluations

98

Issue 1: voluntary change from cost model to revaluation model

Change from cost model to revaluation model
What do you think?

Accounting policy choice: a First-time Adopter of IFRS Accounting Standards must choose separately for each class of PPE (and those intangible assets the fair value of which can be determined with reference to an active market) either: (i) the cost model; or (ii) the revaluation model.

Can an entity change its accounting for a class of PPE from the cost model to the revaluation model?

Change from cost model to revaluation model
Summary of discussion

Can an entity change its accounting for a class of PPE from the cost model to the revaluation model?

Discussants' consensus view:

» Yes, one can voluntarily change a class of PPE from the cost model to the revaluation model because the revaluation model would provide users with more relevant information (IAS 8.14(b)), ie:

  » current economic value of the asset in financial position; and

  » in financial performance for the period—current economic measure of depreciation (service potential consumption) separately from other price change effects.

101

Issue 2: frequency of revaluation

Frequency of revaluation
What do you think?

Under the revaluation model, an item of PPE carried at its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. (IAS 16.31)

How frequently (at what interval) should revaluation be done on PPE?

Frequency of revaluation
Summary of discussion

How frequently (at what interval) should revaluation be done on PPE?

Discussants' consensus view:

- Because revaluations must "be made with sufficient regularity to ensure that the carrying amount does not differ materially from" fair value at the end of the reporting period (IAS 16.31), it is inappropriate to specify a fixed time-interval between revaluation events.
- Put another way, revaluation must be performed whenever reporting-date carrying amount would differ materially from fair value.

Issue 3: revaluation of intangible assets

Revaluation of intangible assets
What do you think?

An entity may choose to account for a class of intangible assets using the revaluation model, unless there is no active market for those items. (IAS 38.72)

Can intangible assets be accounted for using the revaluation model?

Revaluation of intangible assets
Summary of discussion

Can intangible assets be accounted for using the revaluation model?

Discussants' consensus view:

» Only for those intangible assets whose fair value can be measured by reference to an active market can an entity elect to account for using the revaluation model (IAS 38.75)

» Consequently, most intangible assets cannot be accounted for using the revaluation model because, for example, an active market cannot exist for unique intangible assets like brands, newspaper mastheads, music and film publishing rights, patents or trademarks (IAS 38.78)

» Examples of intangible assets that do trade in active markets include, Bitcoin and EU ETS certificates.

107

Issue 4: accounting for revaluations

Accounting for revaluations
What do you think?

Presentation of the revaluation of non-financial assets affects the statement of financial position (sometimes called the balance sheet) and the statements of financial performance.

How are upward and downward revaluations presented in financial position and in financial performance?

Accounting for revaluations
Summary of discussion

How are upward and downward revaluations presented in financial position? Discussants' consensus view:

- The carrying amount of the revalued asset is the revalued amount less subsequent depreciation and subsequent impairment, if any (IAS 16.31)
- The deferred tax effects (typically a liability), if any, resulting from the revaluation are recognised in accordance with IAS 12 *Income Taxes*.
- Consequently, the revaluation surplus reserve component of equity is measured net of the associated deferred tax effects.

Accounting for revaluations
Summary of discussion

How are upward and downward revaluations presented in financial performance? Discussants' consensus view:

» a revaluation increase (with associated tax effects) is presented in other comprehensive income (OCI) except to the extent that the increase is presented in profit or loss because (and only to the extent that) it reverses an impairment of the same asset previously recognised in profit or loss.

» a revaluation decrease is presented in profit or loss except to the extent that it is presented in OCI (with associated tax effects) because (and to the extent that) it reverses the residual amount of a prior period revaluation of the same asset previously presented in OCI.

111

Accounting for revaluations
Summary of discussion

» 1 January 2011 you pay ETB1 million and gain control of a building
  » estimated useful life = 40 years
  » depreciation method = straight-line
  » nil residual value

» 31 December 2018: fair value = ETB1.2 million

» 31 December 2026: fair value (= recoverable amount) = $300,000

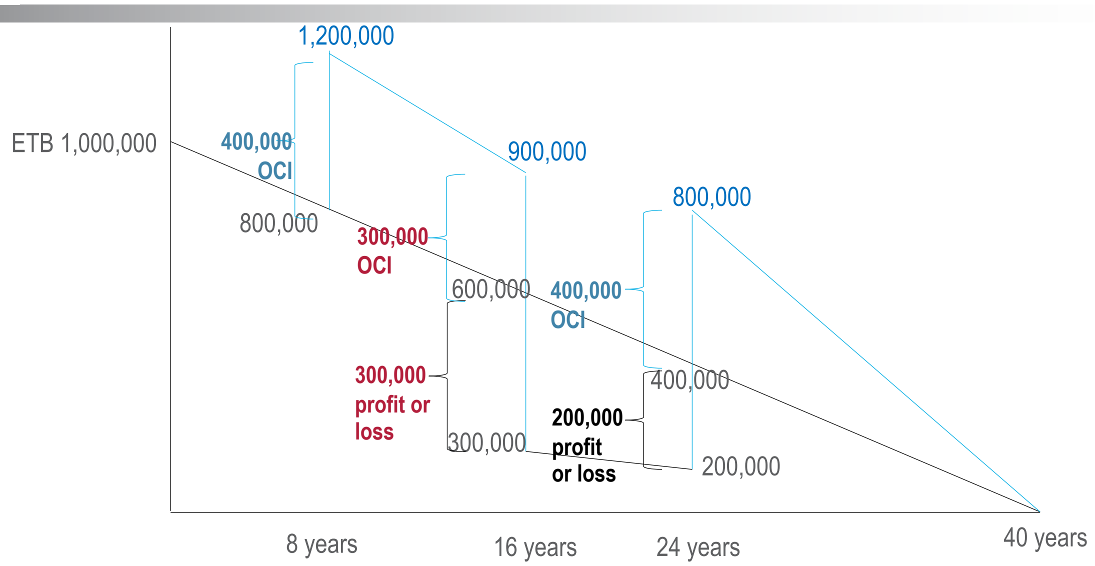
» 31 December 2034 fair value (= recoverable amount) $800,000.

Plot in a graph the carrying amount of the asset over its useful life using the revaluation model as specified for PPE.

Measure the effects of accounting for the building using the revaluation model on financial performance for the 40-year period ended 31/12/2050. (For ease of explanation, this illustration ignores deferred tax effects.)

112

Accounting for revaluations
Summary of discussion



113

Accounting for revaluations
Summary of discussion

Financial performance for the 40-year period ended 31/12/2050	ETB
Profit or loss	**(1,500,000)**
- Depreciation (2011-2050)	(1,400,000)
- Impairment (in 2026)	(300,000)
- impairment reversal (in 2034)	200,000
Other comprehensive income	**500,000**
- Revaluation (ETB400,000 in 2018 + ETB400,000 in 2034)	800,000
- Revaluation decrease (in 2026)	(300,000)
Comprehensive income	**(1,000,000)**

114

Impairment

Index of impairment issues

» Issue 1: when to test PPE, investment property and intangible assets for impairment

» Issue 2: how to test PPE, investment property and intangible assets for impairment

116

Issue 1: when to test PPE, investment property and intangible assets for impairment

117

When to test PPE, investment property and intangible assets for impairment?
What do you think?

IAS 36 *Impairment of Assets* generally uses an approach that triggers impairment testing (ie measuring recoverable amount) only when impairment is indicated. However, specified assets must be tested for impairment every year.

(IAS 36.9–.17)

When are PPE, investment property and intangible assets subject to the indicator trigger for impairment testing?

When must PPE, investment property and intangible assets be tested for impairment irrespective of whether there are indicators of impairment?

When to test PPE, investment property and intangible assets for impairment?
Summary of discussion

When are PPE, investment property and intangible assets subject to the indicator trigger for impairment testing? Discussants' consensus view:

- At the end of each reporting period, management must assess whether there is any indication (whether internal or external) that an item of PPE, investment property (accounted for using the cost model) and intangible assets may be impaired. Any such indication triggers the recoverable amount impairment test of the asset. (IAS 36.9)
  - Note: investment property accounted for using the fair value model is not subject to impairment testing.

119

119

When to test PPE, investment property and intangible assets for impairment?
Summary of discussion

When must PPE, investment property and intangible assets be tested for impairment irrespective of whether there are indicators of impairment? Discussants' consensus view:

- Irrespective of whether there are indicators of impairment the following items must be tested for impairment at least annually: (i) intangible asset with an indefinite useful life; (ii) intangible asset not yet available for use; and (iii) goodwill. (IAS 36.10)
- However, some exemptions from such annual impairment testing are specified. For example:
  - When previous calculations show significant headroom (ie recoverable amount significantly > carrying amount) and no event/s in the intervening period have occurred that would eliminate that headroom. (IAS 36.15)
  - When previous analysis shows that an asset's recoverable amount is not sensitive to one (or more) of the impairment indications (IAS 36.15). For example, if short-term market interest rates have increased but do not have a material effect on the discount rate used for the asset with a long remaining useful life (IAS 36.16).

120

Issue 2: how to test PPE, investment property and intangible assets for impairment

121

How to test PPE, investment property and intangible assets for impairment?
What do you think?

Impairment testing means measuring the recoverable amount of an item, ie greater of its fair value less costs to dispose and its value in use. (IAS 36.18) However, practical expedients are specified for circumstances in which recoverable amount cannot be determined item-by-item. (IAS 36.22, .80 and .101)

What level must the impairment test be performed at?

How to measure recoverable amount (ie the greater of fair value less costs to dispose and value in use)?

122

How to test PPE, investment property and intangible assets for impairment?
Summary of discussion

What level must the impairment test be performed at? Discussants' consensus view, recoverable amount is determined:

- for each **individual asset** (ie item-by-item), when it is practicable to do so (IAS 36.22).
- for a **cash-generating unit** (CGU) to which the asset belongs when the asset does not generate cash inflows that are largely independent of those from other assets of the CGU (IAS 36.22).
  - A CGU is "the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets." (IAS 36.6).
- for the CGU or group of CGUs to which the **corporate asset**, for example corporate head-office, (or allocated part of a corporate asset) belongs (IAS 36.100–102).
  - Corporate asset are "assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units." (IAS 36.6).
- for **goodwill** the CGU or group of CGUs that represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. However, that level cannot be larger than an operating segment before aggregation as specified in IFRS 8 *Operating Segments* (IAS 36.80).

How to test PPE, investment property and intangible assets for impairment?
Summary of discussion

How to measure recoverable amount (ie the greater of fair value less costs to dispose and value in use)? Discussants' consensus view—although recoverable amount is defined as the greater of an asset's (CGU's or collection of CGUs') fair value less costs to dispose (FVLCTD) and its value in use (ViU) (IAS 36.18), practical expedients are specified for circumstances in which only one of FVLCTD or ViU need be estimated. For example:

- Use either FVLCTD or ViU when either is calculated and exceeds carrying amount (IAS 36.19) because the asset is not impaired.
- Use ViU alone when it is impracticable to measure fair value (IAS 36.20).
- Use FVLCTD alone when there is no reason to believe that ViU materially exceeds FVLCTD (IAS 36.21).

How to test PPE, investment property and intangible assets for impairment?

Summary of discussion

How to measure recoverable amount (ie the greater of fair value less costs to dispose and value in use)? Discussants' consensus view (continued):

- To measure FVLCTD apply IFRS 13 Fair Value Measurement to measure fair value and then deduct from fair value the estimated costs to dispose (IAS 36.28).
  - Examples of costs to dispose include "legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale." (IAS 36.28).
- To measure ViU estimate the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal and apply the appropriate discount rate/s (IAS 36.31). (In doing so, take account of possible variations in the amount or timing of those future cash flows, the risks specific to the asset and other specified factors, like liquidity.) (IAS 36.30).

How to test PPE, investment property and intangible assets for impairment? Contrasting value in use and fair value in circumstances in which both are measured using a DCF model

Summary of discussion

	Value in Use	Fair Value
Measurement objective	Estimate PV of future net cash inflows	Estimate selling price in market
Measurement perspective	Entity-specific	Market participant
Assumed use of the asset	Current use	Highest and best use
Market conditions	Management's expectations (but constrained)	Market participant views of current market conditions
Valuation technique	Discounted cash flows	Whatever market participants use
Discount rate	'market based'	Market rates
Discrete projection period	5 years	Market participant expectations

How to test PPE, investment property and intangible assets for impairment? Contrasting value in use and fair value in circumstances in which both are measured using a DCF model

Summary of discussion

	Value in Use	Fair Value
Future improving/enhancing asset's performance	Ignore	Market participant expectations
Possible future restructurings	Ignore	Market participant expectations
Growth rate	Usually average historical growth rates (but constrained)	Market participant expectations
Growth rate beyond discrete projection period	Steady or declining (unless convincing evidence)	Market participant expectations
Use of observable data	Reasonable and supportable assumptions	Maximise observable inputs the 'fair value hierarchy'
Tax assumption	Pre-tax: cash flows and discount rates	Silent (must be internally consistent)

127

How to test PPE, investment property and intangible assets for impairment? Contrasting ViU and fair value 'forward' contracts: asset subject to impairment testing used in generating the commodity specified in the contract (ie the 'underlying')

Summary of discussion

The contract is…	Value in use	Fair value
…in the scope of IFRS 9	The contract is recognised as a separate asset/liability that is measured at its fair value. Consequently, the contract is irrelevant to calculating the VIU of the asset that produced it.	Irrespective of whether it is recognised separately, the value of the 'fixed-price contract to sell the commodity' is not necessarily relevant to measuring the fair value of the asset that produced it "because fair value reflects the current market conditions in which market participant buyer and sellers would enter into a transaction." (paragraph 16 of IAS 41 *Agriculture*)
…out the scope of IFRS 9 and 'in the money'	The contract **is relevant** to calculating VIU of the asset that produced it only to the extent that the contract: (i) has not been recognised as a separate asset; and (ii) is not used to 'protect' another asset from impairment (eg inventory).	
…out the scope of IFRS 9 and 'out of the money'	The contract **is relevant** to calculating VIU of the asset that produced it only to the extent that the contract: (i) has not been recognised as a separate liability (eg when the contract is onerous); and (ii) is not taken account of in measuring the impairment of another asset (eg, inventory).	However, if entered into at the reporting date in an arm's length transaction then the price specified in the contract could inform the input 'commodity price' for the coterminous delivery date.

128