Common Errors – Property, Plant and Equipment 14/09/2023

Alison Wood:

Hi, everyone. Welcome to today's webinar regarding Common Errors: Property, Plant, and Equipment. I'm Alison Wood from CCH Learning Wolters Kluwer and I'll be your moderator for today. Just a few quick pointers before we get started. I'd like to let you all know within the handouts section is where you can find the PowerPoint presentation. Just the handout section of the GoToWebinar panel there. Any sound problems, you can toggle between audio and phone. Shortly after the session today, we will send you an email letting you know the e-learning recording is ready to be viewed. In terms of questions, please type those into the questions box. I will collate those questions and have a Q&A at the end of today's session.

CCH Learning also offers a subscription service, which many people have termed Netflix for professionals. It provides members with access to our entire library of recordings as well as live webinars for a very competitive flat fee. That's for over 500 hours of content, and for CPD purposes, your viewing is logged automatically. Your presenter today is Dean Ardern, director at BDO Australia. Dean has been advising on IFRS and other financial reporting matters for over 15 years. Having worked with a range of clients in both for-profit and not-for-profit sectors, Dean understands the challenges preparers face. Dean's primary role is to identify practical and compliant reporting solutions for clients and assurance staff, and to achieve this, Dean works at building constructive relationships with clients with the view to providing responsive, accurate, and outcome focused technical advice and guidance. Without any further ado, I'll now pass you over to Dean to commence today's presentation.

Dean Ardern:

Thanks, Alison. Can you see my screen? I suppose that's the question.

Alison Wood:

Yes. Thank you, Dean.

Dean Ardern:

You can? Great. Excellent. Thanks, Alison. Today, yeah, we're going to talk about common areas that we discover in various sort of scenarios where people apply IAS 16 or AASB 116 if it's in Australia. I've thought the best way to perhaps address this topic would be to do a similar structure as I did to the last session on intangible assets, so what I'll be doing is sort of running through the standard at a very high level, but at various junctures, what I'm going to be doing is identifying some of the common areas that we find when people are applying the standard. You can see there that the areas that we're going to be coming today are introduction to IAS 16, definition scope, initial recognition, initial measurement, issues that arise on initial measurement, subsequent accounting. Subsequent accounting includes both subsequent capitalization of costs and depreciation or re-evaluation, and then issues that arising in that context, depreciation, and issues arising around depreciation.

When I was thinking about this topic, I think the one thing that was foremost in my mind was the idea that we've probably had property, plant, and equipment in accounting for a millennium. It's been there forever, but we still do find preparers do make mistakes around accounting for property, plant, equipment, and it's sometimes in the most unexpected areas. What I'll do with that further as we all move on, one thing I will do is maybe just given

that we might have some limited bandwidth today, I might actually turn my camera off to make sure we don't lose any quality of the presentation. Before we start, as we always do, I'd like to begin by acknowledging the traditional owners of the land in which we meet today and pay our respects to elders past, present, and emerging, and also extend to anybody on the call with respect to Aboriginal and Torres Strait Islanders people here today.

The introduction, at a very high level, this is what IAS 16 or AASB 116 looks like if you were to step it out as a flow diagram. The reason why I've provided that slide is probably to compartmentalise the different places in which errors might occur. Anyone who's listened to me present on this type of topic before, the one thing you probably would be aware of that I do really emphasise is definitions and scope, and hat's often the first place that errors are made. The reason why I emphasise that is because if you manage to get the right accounting standard, you've got the right applicable standard, typically, your accounting won't be too wrong or wrong at all, but if you get the wrong standard, it's almost 100% probability that you are not going to get the right accounting even if the accounting standard looks similar to the standard that it should be in.

The reason we have different accounting standards is often because around subsequent measurement and other types of accounting requirements, and so as a consequence, if you get the wrong accounting standard in the first place, if you apply the wrong standard to something in the first place, it will be the case that, typically, your accounting won't be right and it probably won't be right by a long shot, so I do emphasise that idea around definitions and ensuring that you understand what the definitions are, you apply them correctly, and also understand what the scope of standard is before you even move past that to thinking about what should be the right accounting. Let's start off with definition and scope and initial recognition. Now, IAS 16 is an interesting standard because it sort of mixes up recognition and measurement, and I'll get to that in a second, but if we look at the definition, so what is property, plant, and equipment?

This is the way we work in accounting. We bucket things. The way we bucket things is we bucket them by virtue of definitions, and so we look at an item and we ask ourselves what is it, and when we are asking the question, what is it, what we're actually asking is what are its features? What are its key features or what are its defining features? We're looking for those defining features in things to ensure that we are then applying the right accounting standards. If you're thinking about property, plant, and equipment, now it's a pretty broad category of things, but what we're looking for are things that are tangible, so they're tangible items, they're held for use in the production or supply of goods or services or for rental to others or for administrative purposes. Again, really quite a broad category of criteria, and they're expected to be used during more than one period. The last stop point... I mean you can obviously... That makes sense.

If it's not going to be used for more than one period, we expense it irrespective of what it's going to be used for. It's going to have a life more than one reporting period and it's being held for production or supply of goods for rental or for administrative purposes. Now, when we get to... That's the definition. All things that have those criteria meet the definition of property, plan, and equipment, and therefore are potentially within the scope of IAS 16 or AASB 116. That's the thing we've got to keep in mind is that it's a gradual process of whittling down exactly what's within the standard by virtue of first determining a definition, applying the definition of the item, and then working our way through the other criteria in the standard.

The next criteria, and this is applicable to for-profit entities, the PPE is recognised as an asset at its cost if, so first and foremost, it's got to meet the definitional criteria above, it's got to be probable that there's future economic benefits associated with the item that'll flow to the entity, and it's got to have a cost that can be measured reliably, and that's an unusual for feature in standards. Typically, we separate recognition criteria from measurement, and the reason we do that is because we can say we can identify something and then we apply the measurement criteria, but with PP&E, we actually say you've got to have, and this is applicable particularly for for-profit entities, you've got to have a cost that can be reliably measured before you can actually recognise it.

We're actually combining the recognition and measurement criteria, at least initial measurement criteria, in terms of the identification of the item.

Once we jump through those hoops, it's also helpful to sort of then contrast, and it goes back to what I was saying before about the idea of making that distinction. We bucket things. How do we bucket things? On occasions, you will see scenarios where it's not clear what an item... It's clearly an asset in the sense that it's probably going to last more than 12 months. There's economic benefits, we have a cost, and all of those sort of things. Maybe it's going to be used in operating activities. Sometimes, and this is probably one of the first areas where there's always a bit of a challenge as to the right accounting, are we dealing with something that's really an item of inventory or is it actually PP&E? This is how we make the distinction between inventories in PP&E. We look at the definition of an inventory and contrast it to the definition of a PP&E, and we say, "Okay, inventories are assets that are held for sale in the ordinary course of business."

They're in the process of production for such sale or in the form of materials or supplies that are consumed in the production process. It's very clearly a different group of assets. We will hold inventories of items that will be perhaps utilised later in the production process. Now, again, you have to make a distinction between is this an item that's actually going to contribute to the production or is it going to be consumed within the production? Now, if it's going to contribute to the production, chances are it's going to be PP&E, but if it's actually going to be consumed in the production, then it's likely to be inventory. You say to yourself, "Well, what's it matter? They're both assets." Well, they have very different subsequent accounting methodologies applied to them. With inventory, it's lower cost of replacement cost. Whereas with PP&E, you've got a depreciated model or re-evaluation model. It's very different accounting subsequently, and as consequence, you have to make sure that that distinction is correctly applied in the first instance.

I think I mentioned there before, PP&E in contrast, their tangible items that are effectively held for use in the production or supply of goods and services, so they're facilitating that production, they're not actually consumed as a part of that, or they might be held for rental or other administrative purposes. Just to highlight that difference, so the distinction between what might be inventory, what might be servicing equipment and maybe standby equipment, an example there, entity owns and operates an electricity network and has just completed construction of a new electricity power station. The power station consists of six turbines, four to be used for electricity production, two in the event that any of the first four turbines break down. Now, the two turbines are constructed as standby equipment, therefore probably meet the definition of PP&E. If we go back to that definition, they're going to be used in the production. They're going to last more than a year. They have all of the criteria that indicates that they're PP&E, so therefore we'd classify them as PP&E.

When we look at the scope and make a distinction between scope and definition, so it's this sort of process that accounting standards go through where they whittle down what actually is within the scope of the standard. We start with definitions. We say PP&E is everything that meets the following criteria, and then when we actually apply scope, what scope does is to actually sort those PPE perhaps into other accounting standards subject to certain requirements. Development of accounting standards is not a... All accounting standards weren't developed at once together. They've been developed over time and progressively and iteratively. As a consequence, sometimes items that are meeting the definition to be within the scope of one standard, it actually pushed into the scope of another standard because that standard perhaps pre-existed or the requirements in those standards are better suited for that particular item. Not withstanding there's no accounting standard that maybe deals with it specifically as well.

IAS 16 applies to all accounting for all items of PP&E and this how scopes work. It says everything except when another standard requires or permits different accounting treatments such as IFRS 16 leases or IAS 40 for investment property. To think about the differences between those, obviously, leases is a distinction between PPE and leases. When you think about leases, you've got the right to use an asset, whereas PP&E, the implication

is you actually own control, maybe legally have title to the asset. The distinction between PP&E and investment property is also about the usage, about how it's going to be used. Makes it clear there too that IAS 16 doesn't apply to PP&E classified as held for sale in accordance with IFRS 5, so it's accounted for under IFRS 5. Biological assets related to agricultural activity, and make a distinction there between biological assets and bearer plants. Bearer plants are actually within the scope of IAS 16, but biological assets are outside.

Recognition and measurement of exploration and evaluation assets. They've got a very specific accounting for them. Sometimes, you get, and that's sort of alluded to there in the last dot point, sometimes you get PP&E that's a part of exploration and evaluation assets, so you have to actually work through IFRS 6 as an accounting standard to understand how those two things are accounted for, and also non-regenerative resources such as mineral rights and mineral reserves. Again, you might find that there's PP&E related to those things, so an entity that's got say mineral rights might also have PP&E, but that doesn't necessarily mean that that PP&E is actual mineral rights or exploration evaluation assets. You have to work through the actual accounting standards to understand that.

One thing that maybe you wouldn't pick up if you read... Certainly, you wouldn't pick it up if you read IAS 16, but you might not pick it up if you read AASB 116 either, is that there's some specific scope outs but it's not in actually AASB 116, it's actually in AASB 140 for investment properties. Now, I probably mentioned it before, in Australia, we adopted IFRS, but we adopted it for all entities that prepared general purpose financial statements including not-for-profit entities. What the AASB did at the time when they adopted those standards for not-for-profits was that they put in some of these what we call Aus-paragraphs, which apply specifically to not-for-profit entities within Australia, and it might apply to public sector or private sector, subject to whatever the criteria are.

Now, there's one scope out that it's not in AASB 116 but it is AASB 140 that not-for-profits should be aware of when they're trying to understand where the accounting for particular items of property exist. The requirement in AASB 140 Aus 9.1 says in respect of not-for-profit entities, so this is applying to specifically not-for-profit entities, property may be held to meet service delivery objectives rather than to earn rental or for capital appreciation. In such situations, the property will not meet the definition of investment property and will be accounted for under AASB 116. What's actually happening is AASB 140 is actually telling you to go back to AASB 116 if you meet this criteria. This property might be held for strategic purposes, but it also might be property held to provide a social service including those which generate cash in-flows where the rental revenue is incidental. We do have and aware of entities that, as a part of what they do, often receive government grants, and part of their operations is to house people but also provide education, health, and other support services to those people.

Typically, the rental, and sometimes they will be required to pay rental in the property that the not-for-profit entity maybe is owning or is maybe renting itself, they will be required to pay rental, but the rental, the accommodation is really incidental to what the not-for-profits objective is. Typically, what it is to help those people with education, with reintroduction into society or to other special needs arrangements where they need assistance to develop the skills and the ability to perhaps live more independently. A big part of their job is to do that service side of their objectives, to provide the services. The accommodation is really only incidental often because it makes it easier to provide the services if those clients have an accommodation that they can live in. If you're in a not-for-profit entity, you need to be aware that there is this scope out which sends you back to 160, so notwithstanding, you might look at AASB 140 and say, "Oh, look, we're renting this property out. We own it but we rent it out," so it looks like investment property.

If you're a not-for-profit, you really need to consider those requirements because that will actually send you back to AASB 116, and it's again, the idea that if you have to go back to a different standard, chances are particularly the subsequent accounting will look different. Common errors. What could possibly go wrong? Well, obviously, not applying the definition nor the scope criteria. That's a really obvious one. Looking at an item and making sure that you confirm that it meets all the criteria to be defined as PP&E and it's not otherwise excluded from IAS 16 as

a consequence of the scope requirements and standards, that's really essential. Other things that could possibly go wrong, and we see it on occasions too where I'll often be... A client might send me a document and it looks like a financing document and they'll say to me, "If I've got a lease..." Or actually, "Is this a lease or not?" Sometimes, I just say, "Well, I've got a lease. Here's the requirements." Excuse me.

When I read the document, it's fairly unclear as to what exactly is going on. The kind of things you need to understand fundamentally with those types of arrangements is to say... Excuse me again. You need to understand where does the legal ownership of the asset lie? Is the legal ownership transferred at the end of the financing arrangement or is it transferred at the start of the financing arrangement? If the preparer owns the asset and has legal entitlement to it from the start, then it's not a right to use. They actually own it so therefore it won't be a lease, but sometimes with these documents, it can be hard to tell what's actually happening. A recent one I dealt with where I was really struggling because interestingly, the financing document was almost like a multi financing document, so it was a document where the financier might use to do all sorts of financing arrangements because there were schedules at the back of the document to say, "If you do this, then this is the kind of arrangement and it's this," and so on and so forth.

Unsurprisingly, and this is the consequence of IFRS 16, is the accounting for perhaps a lease doesn't look much different from the accounting from an asset that you own and therefore is that you actually have financing attached to it. That was the whole point of IFRS 16 was to try and remove that distinction because, in substance, it's exactly the same arrangement, but there are some differences because you would expect, for example, if you own the asset or if you have the capacity to buy the asset at the end, then you might have different asset balance and liability balances depending on what your intentions are, but the substance of the accounting will look the same, but it's important to remember that you still need to be able to identify what's owned and what's leased. Another thing that we see pops up from time to time is where particularly land where an entity's purchased land, they don't actually haven't decided what they're going to use. Maybe they're going to develop it into inventory or maybe they're just going to resell it.

Now, in that situation, if the intention is unclear, then it has to actually be classified as investment property. I think you'll find the requirements in the investment property standard around that, but it's important to understand, if you think about the definition of PP&E, it makes it clear saying that the asset is going to be used in production of supply of goods and services. Now, if it's not or if it's unclear, then the chances are it's obviously not PP&E. Other scenarios that we come across as situations where assets are owned, but they are operated for a purpose. Now, if that's the case, subject to the nature of the arrangements between the owner and the operator, you can get different accounting outcomes. Now, if the owner also operates a hotel out of a property, then you'd probably treat it as PP&E because it's being held to produce services.

If, however, the owner of the property then rents the property to a third party who then runs the hotel out of the property, it may or may not be still PP&E subject to the nature of the relationship or the legal arrangement between the owner and the lessor, I'm sorry, the lessee. In that case, you need to really look carefully at exactly what it is that what is it the owner of the property is going to do. Now, if the founder of the property is simply saying, "I make the property available to you, I'll do maintenance on the property as and when it's required, but beyond that, that's all I'm doing," you have all of the rights and obligations as the owner. Other than that, then you're probably going to find that that is a rental property and therefore probably potentially within the scope of 140.

However, if the owner of the property is actually doing other significant services, so for example, maybe they're running the, I don't know, online booking part of the business so people can actually book the property, then it would draw attention to the fact that you are providing some services there, or at least as the owner of the property, that you are doing things which look like you are running the business, and so therefore the question might be asked as to whether or not this is actually just PP&E. I mentioned before the not-for-profit entities

requirements in 140 about service delivery objectives and how that can actually potentially change the classification of the asset. They're probably the keyers we see around classification. On initial recognition, I might skip through these slides because they're relatively straightforward and really it's just to give you context perhaps to the issues and then discuss a bit later. When's PP&E recognised? When do you put it on the balance sheet? I think we mentioned before. It meets all the criteria, it's probable, and it's got a cost that can be measured reliably.

What is cost? Keep in your mind, I'm talking from a for-profit perspective here. If you are not-for-profit, you're thinking about not-for-profits, then there are specific requirements you can apply a fair value approach on initial recognition for PP&E because, again, AASB did see the situations where often not-for-profits are just simply granted assets, just given them for no cash or for nominal cash. In that situation, you would measure the asset at its fair value, but when dealing with just for-profit entities, we just deal with costs. Now, from perspective of both entities effectively, which are trying to determine cost, it's the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire the asset at the time of its acquisition or construction, where applicable, the amount attributed to that asset when initially recognised in accordance with specific requirements of other IFRS, for example IFRS 2. It's really about what resources did I expand to acquire this asset? Now, did I pay cash or cash equivalents? Did I swap other assets? If I constructed this asset, what was the cost?

Maybe I offered my employees some share-based payment arrangements, so the cost of those might get included in the cost of the cost base of the asset. It's whatever it costs you, whatever resources you had to give up to actually acquire it. We can break the elements of cost down into three components, the purchase price, other directly attributable costs, and initial estimates of cost to restore the asset side. Purchase price, usually fairly uncontroversial. Particularly the invoice price, it's usually the asset purchase price. You might have some import duties or other taxes that are non-refundable, so you might have to capitalise those as well, and there might be other things like rebates and trade discounts that you need to deduct as well, so in the sense that the fair value is net of any of those rebates and trade discounts.

Directly attributable costs, this is probably where it gets a little bit more challenging because particularly, in the context of construction, usually direct attributable costs associated with the acquisition of an asset are usually relatively uncontroversial, but if you're building an asset, the question that often arises is how wide do we throw the net to encapsulate the costs of the production of the asset? The principle I always use is this idea of nexus. The idea is there's a nexus between the costs incurred and actually achieving the outcome of constructing asset. If there's a nexus there, if you can see the nexus, then you could probably say, yeah, they're directly attributable. If the nexus is weak or it just doesn't exist, then your argument that perhaps these costs should be included in the cost base of the asset might be a little bit more challenging to support, but if we look at the types of directly attributable costs, we normally see things like cost of employee benefits arising directly from the construction or the acquisition of the item of the PP&E.

When you think about employee benefits to acquisition, it might be things like your legal department's time on reviewing maybe the legal contract to acquire the assets, so something like that is directly attributable costs. Cost of site preparation, so not directly related to the construction of the asset, but getting the site into a state that could be used. The initial delivery and handling costs, installation and assembly, cost of testing, and other professional fees. There might be some legal costs that you'd have to incur to... If you employed somebody to construct something to you, the legal costs associated with signing the agreements. The last one element of cost, which is often, not often but sometimes actually forgotten is that initial estimate of cost to restore the side of the asset. Now, typically, and I think the best way to contextualise this is to think about... Imagine if I had a long-term lease of a land, but I built a building on the land, and at the end of lease, I had to remove the building. That's the kind of cost to restore the side of the asset that I'm thinking of.

If you own the land and own the building, you're obviously not going to have an obligation to remove the item at the end of its life, but if you don't own the land on which say maybe something sits or at least the property in which it sits, then you might have an obligation, and that obligation has to be recognised as part of the cost of the asset because ultimately, that's the part of the cost that you're incurring. You're setting yourself up for this obligation. That's an important one. We often see entities don't often give that cost sufficient, I suppose, sufficient consideration when they're determining the cost base of an asset, and we certainly saw that was the case when IFRS 16 was brought in. I think a lot of entities had to look again at their make good provisions and understanding exactly what they had when they, particularly in relation to their leasehold improvements and those types of PP&E that they had within rental properties.

Examples of costs that are not capitalizable to PP&E. Again, I think when you think about these ones, think about the nexus. The idea is what's the nexus between the cost incurred and the benefits associated with the asset? Cost of opening a new facility? Well, not really. Cost of introducing a new product or service line? Again, unrelated to the economic benefits of the asset. Advertising doesn't change the assets, economic benefits, promotional activity is the same. Cost of conducting business in new location when you class a customer? Again, not really adding to the benefits of PP&E even though you might've set up an office in a different country. Administration and other general overheads, repairs and maintenance, research to choose which asset to acquire, cost of raising borrowings, and cost of raising equity. The last two there, cost of raising borrowings and cost of raising equity, could be capitalizable in a sense to the actual financial instruments.

Keep that in mind is it not necessarily to maybe the cost of the asset, the PP&E, but may be capitalizable in a sense that, for example, direct incremental costs associated with borrowing money, often you can actually capitalise those to the borrowing and recognise them as interest expense or part of interest expense over the term of the borrowing, and the same with equity as well. Hidden costs, and this is another one where we see sometimes people get caught out particularly around things like assets that are PP&E, but more like plant equipment type, assets, photocopiers. A lot in the medical industry, you often see MRIs, those type of significant pieces of equipment, that there might be some training and maintenance costs or prices built into the cost, and you need to include those or you need to exclude those from the carrying amount of the asset because they don't relate to the asset. They relate to...

Often they'll bundle these costs up into one bundle, so you have to be wary when you're reading through the contracts to make sure that you can see that there's no other sort of these service-based costs sitting within there that would otherwise be recognised as prepayments of future services. PP&E acquired using deferred considerations. A couple of things that we do see people maybe need to give more consideration to when they actually come across this situation. Deferred consideration is the idea that there's a fixed amount of money but you're paying it over a period of time, and therefore what's happening is the vendor is giving you some credit terms. In that situation, firstly, we'd consider about what's the period over which these credit terms have been provided. Now, if they're over 12 months, we wouldn't typically imagine that maybe the financing aspect to them would be material, so we probably wouldn't actually look to discount the amount, but if they are over more than 12 months, then certainly, that would be the thing.

The other thing you'd need to consider is what the acquirer's interest rate is. What are they actually doing? What's going on here? And then understanding what's a market rate for this, and would that make the financing component here material? That's probably the key bit with these is, first, identifying if they exist, and secondly, understanding whether or not they're material. We typically don't see a lot of preparers doing... You typically don't see a lot of long-term consideration arrangements except for very, very large item acquisitions, so when you see smaller ones, keep that in mind, but if they're dealing with the larger costs over a longer period of time yet you'd expect that the interest is probably going to be material, and so therefore you'd need to account from a deferred consideration. The other thing to do there is to actually distinguish it between deferred consideration and you like your contingent consideration that you might see at a business combination.

We don't see it much in the context of PP&E, although you might sometimes. We do see it a little bit with intangible assets, but there's scenarios where the vendor says to you, "Subject to the performance of the asset, you'll pay me X over the next five years." Now, that's a different accounting than deferred consideration. Deferred consideration is you're going to pay me X, but you're going to pay me in the following instalments over whatever period. Contingent consideration is really subject to the performance and underlying asset, and the accounting for that is not so clear. If we have looked at this issue and raised it, and I think I might've raised it and I've talked about it in other presentations, but be aware that sometimes that arises and that the accounting is not necessarily clearly outlined in the accounting standard. There is two schools of thought. One is that it's an equally proportionally unperformed contract, so as this thing provides services, you pay for them, and in which case then, really the cost wouldn't be necessarily recognised upfront. It would be recognised as an operating expense over time.

Or the alternative view is just saying, "Well, no, you should be able to work out what the fair value of the consideration is and we'd apply similar principles as we do under say for three when we have a business combination with contingent consideration and we capitalise the cost upfront." Be aware that deferred consideration is not contingent consideration, and that's a different thing, and it has potentially different accounting. Again, that might be somewhere. We don't see a lot of those scenarios arising, but from time to time, you do so you've got to be aware of those as well. Government grants. Usually, pretty straightforward. My preferred, and under IAS 21, there's effectively two ways you can do it. You can either recognise the grant as a reduction. You defer it and you recognise it as deferred effectively income, and then amortise that to P&L over the life of the asset, or alternatively, what you can do is offset the government grant against the carrying amount of the asset, and then that shows a lower depreciation expense playing out through P&L over the life of the asset.

My preferred approach with those two is the first one, directly reducing the cost of the asset, and the reason being is it just keeps your balance sheet nice and clean, and people don't have to worry about workarounds and remembering to allocate a part of that if you've got a deferred income amount allocating that to P&L. It also gets messier if you, for example, if the asset's impaired, or for example, you sell the asset. You've got to remember you've got to do something with that deferred income amount, but if that government grant's already included in the cost of the asset, you don't have to worry about it. It's already taken care of. That's my preferred approach, but I acknowledge that there's two approaches under the accounting standard. We do sometimes people see people getting themselves into a bit of a mess when they defer that item, and that's probably my reason why I prefer the first approach, but horses for courses.

Ceasing recognition of costs is another one too. It's the idea that once that item of PP&E is in a location and condition necessary for it to be capable of being operated in a manner intended by management, all of the costs associated with the PP&E should stop being capitalised. Any costs from that point in time are effectively and not adding to the economic benefits to the asset, and therefore should be expense. That raises some interesting things around and it has done in the past because when we introduced bearer plants into the IAS 16, that made some interesting things. Bearer plants are effectively things like fruit trees, nut trees, any kind of plant that produces agricultural produce, but itself is not agricultural produce, so make a distinction between a fruit tree and maybe wheat. Wheat is the whole thing is produce. Whereas for a fruit tree, fruit tree might last for five to years subject to various aspects to its health and its productivity.

But in that situation, bear trees, there's always been this question around, well, hang on, I've got the bearer tree in the ground, it's a grafted one-year-old tree, it's not going to become productive until year five. What do I do with the costs incurred for the next five years before it starts bearing fruit and when do I decide it's actually in a condition necessary to be capable of being operated? Typically, that's when it's bearing fruit, but sometimes, you do find the bearer plants might be in the first year or two, that fruit is actually not harvest. With bearer fruits that becomes a bearer plants that becomes a bit of an issue, typically, there's always a little bit of give or take in terms

of understanding when PP&E are in a location conditioned necessary, particularly if there's testing that's required to ensure that the PP&E are working properly.

Typically, what you'd often see is there might be signoffs, so there might be a sign-off particularly when you say with property, when you take possession of a property, there'll be a sign-off as to it being able to be habited, so you might be looking for those legal sign-offs as an indication of when that capitalization period finishes. Now, let's look at some of the issues that arise on initial measurement in more detail. What could possibly go wrong? Well, quite a few things. Capitalising costs to PPE that don't qualify for capitalization, so cost of moving operations to a new location, administration and general overheads, all the ones that I mentioned there before, so just not following the accounting standard and capitalising things which shouldn't actually otherwise be there. I mentioned before too, not recognising make good provisions. Like I said, when IFRS 16 came into play, we did see a lot of entities re-examining their make good provisions around removal and restore of leased properties.

Now, you might say that's leased properties, but the provision attaches in fact to any of the leasehold improvements that might be sitting within the leased property, and so they're the items that have to carry the provision, not the lease itself. Again, important to remember we're talking about an obligation. If you own the land and the building, you can't oblige yourself to restore the site once you've finished with it like it's your land and your building. We're only talking about situations where you have an obligation to dismantle, restore, or remove items that you would've otherwise kept. The last one there, continuing to capitalise costs after the item of PPE is in the location and condition necessary to be capable of being operating. Like I said, with these kinds of scenarios, if it's a thing that an entity is regularly constructing assets to use for operating purposes, I would recommend that you think about an accounting policy that clearly identifies.

You have to look at your internal procedures around the development process and when the development process finishes, when the asset becomes ready for use, and you pick a point in there that is an indicator of that asset being in a state that can be used by management. Now, that might be where you get legal sign off that the asset is usable, that maybe there might be some other things in there that you might have development processes that have certain gateways that you have to go through, and that gateway that gets you through to the use of the asset is the one where you say, "Okay, from that point in time, we don't capitalise." So there is a requirement, there's an expectation that you can sort of integrate the operational parts of your business with your accounting to make sure that you can use some of those operational triggers to ensure that your accounting is consistent. Other common errors. Costs of self-constructed assets.

Typically, with self-constructed assets, you'd use the same principles as you do for the acquired assets, so the idea is you're acquiring stuff, and actually the costs, it should be all the same sort of approach, notwithstanding it's a different process. Where similar assets are made for sale to external parties in the normal course of business, cost is usually the same as the cost of constructing the asset for sale. We typically would say, "Okay, well, we'd expect to see those costs to be very similar if you're going to hang onto the inventory as opposed to sell it." Where the entity finances the construction of the asset using borrowings, the requirements in IAS 23 apply, but you need to consider those as well. They've got some very specific requirements about when and how you can capitalise interest costs to the carrying amounts of assets.

For example, borrowings don't necessarily need to be acquired specifically for construction. If they're used towards that, you might be able to allocate some of the interest costs to those particular construction, so you might say, "Well, we borrow a million dollars every year to do five projects or to cover the five projects we've got operating," then you'd think about, "Okay, well, we need to allocate some of that cost across those projects." You don't necessarily have to have the borrowing attributed to a particular project to actually get capitalization, but there are rules around when you have to stop capitalising, and you need to be aware of those. Componentization, that's a common thing you often find with really large pieces of equipment. The things I'm thinking of are things

like airplanes, very large manufacturing factories, those sort of things which have significant large components that might have to be replaced from time to time.

One of the areas we do find that people struggle with is the idea that they have to derecognize a part of the asset when they actually replace a part. So either they have to be able to demonstrate that the depreciation up to that point in time has effectively removed that component of the asset from the wider asset, or they have to be able to say, "Oh, actually, I've got to take away a certain amount." You do have this issue of probably a sub-ledger within your ledger, and so being able to track that, again, that would be the kind of thing I would be looking to integrate with the operational side of the business and understanding how and when they do these things, and understanding what the triggers are, and understanding what they represent. There's nothing better than actually going to people who do this stuff operationally on a day-to-day and getting their understanding of it, and working with them to be able to make the accounting a lot more easier.

That requires information flows, but that's the whole point of what accountants do, I think, is they actually engage with people within the business and making sure that everything works. It does require judgement , but it's important that I think you'd be looking to lean on people from the operational side of the business too to be able to identify components, when they should be derecognized, how to account for new components, what the life of those are. Pre-production income earned. I think I've talked about this before. The AASB recently issued amendments to make it clear that if you are earning income from an asset that isn't in a position or state to be able to be used by management, the accounting for that is through the P&L. Okay? So you don't necessarily reduce the carrying amount of the asset for it. You actually recognise any income from those pre-production activities to be income at the time.

Now, subsequent accounting, as I mentioned before, there's a couple of components to it. One is about subsequent accounting, so adding to the asset. Now, this is an interesting thing because we don't have the same criteria, we don't have the same issue when we look at intangible asset. It's very unusual in an intangible asset scenario to see a situation where an entity adds to the carrying amount of the asset as a consequence of subsequent costs. Whereas with PP&E, you can see that and you get accounting for it. The accounting is just the same as effectively the criteria is the same as initial recognition, so cost has to be able to be measured reliably. You need to be able to demonstrate that there's future economic benefits arising from adding to the asset in that way. If you can't demonstrate those things, and effectively what you're talking about is repair and maintenance, and in that case, what you're saying is, "Well, it's not adding, it's just maintaining."

If it's just maintaining the asset in its current state, then it's not really adding to it, and in which case, then the argument would be you need to expense that item. Now, in terms of doing that, it might change your assumptions around things like useful life, but in terms of adding to the economic benefits from the asset, then you need to be absolutely clear that that's typically it is, actually just expensed. That diagram effectively demonstrates how the kinds of scenarios we think about. So capitalising, we're really talking about major inspections, overhauls, replacements, refits, separate components, so things that actually add to the economic benefits. If we're talking about things like cleaning, day-to-day servicing, replacement of significant part, maintaining benefit, again, we're probably looking at expense because it's not actually adding to the economic benefits in the asset, it's just maintaining what they are.

Another way of looking at it is just saying, "Well, if I didn't do this, I would probably need to depreciate more rapidly the asset." Subsequent measurement, measurement after initial recognition, so ignoring the idea of adding to the asset, now we're thinking about depreciating it or subsequent measurement of the asset. Two models, cost model and the revaluation model. Now, pretty straightforward cost model. Cost less accumulated depreciation, less any accumulated impairment losses, if you've got any, gives you net carrying amount of the asset. The revaluation model's similar. Now, it's interesting, it's a revaluation model that's very different to say to AASB 140 for investment property because in recognition of the idea that this asset is contributing towards

operations, we still depreciate it. It's just that we keep revaluing it as well. Our financial recognition of an asset if you're under the revaluation model, it's a revalued amount less your accumulated depreciation, less you're any impairment losses.

Now, you would expect that... The expectation is under the standard that you revalue the PP&E with sufficient regularity to ensure carrying amount doesn't materially differ from fair value of the reporting date, but often what we see with PP&E under the revaluation model is perhaps those full revaluations are only done every three years maybe at a max, and then in between those dates, effectively you're depreciating and maybe impairing the asset subject to its conditions and various other factors. I just wanted to highlight, again, this is a not-for-profit specific issue that arises with revaluation. Revaluation of PP&E applies to both for-profit and not-for-profit under AASB 116, but the thing is it's applied slightly differently for not-for-profits. For not-for-profits, and I'll come talk to it a bit more in a minute, but for not-for-profits, they can actually offset revaluation gains and losses within classes of assets, which is very different to what for-profits can do.

Okay, so not-for-profits basically have to revalue it, but they get to do revaluations within classes, and what that effectively does is, well, it potentially reduces the volatility of the revaluation movements for not-for-profits. The argument underlying this is that often will not-for-profits will have, or in some cases like the government where they're actually required to do re-evaluation so they don't get the choice, it's abuse to them because you've got such large, especially in the public sector, such large portfolios of particular classes of assets, then they can't actually possibly do individual assets, can't revalue them sufficiently, individually, quickly enough to be able to do the accounting, so often they'll do them on a class basis. You also got the issue that not-for-profits would argue is a lot of these assets are applied to the same thing, so they're not being held for multiple purposes, they're just being held for the same purpose.

Whether that's to provide benefits to the general community or whether it's to provide benefits of the recipients of those not-for-profit services, either way, those assets will have the same purpose, and it's just the fact that we've got a large body of them. We would otherwise have just a couple if we had to. How to calculate fair value, and again, this can be somewhere where we do see some errors. It is the price that we received to sell the asset or to transfer a liability. In this case, we're talking about PP&E. It's to sell the asset in an orderly transaction between market participants at the measurement date. Now, there's lots of things you need to think about. First thing probably jumps out to me and reminds me is that it's the idea of it's an in orderly transaction. Just because you have to sell the asset and you've been offered a price below its market value doesn't necessarily mean that that's its revalued amount. Be aware of that.

First, it has to be an orderly transaction, so it has to consider market participants generally. There's a whole lot of guidance in AASB 13 or IFRS 13 around how do I do that, what are the assumptions I make around how this thing's going to be sold? The other thing you need to be careful of with PP&E is also ensuring that the fair value reflects the highest and best use of the asset. What we sometimes see is that entities don't always actually apply that. They tend to think that their use may be the highest best use when it might in fact be another different use for the asset. There's multiple evaluation techniques, the market approach, the income approach, the cost approach. With PP&E, we typically see the market or income. We sometimes see cost, but obviously, cost is at the lower end of the valuation techniques within IFRS 13.

The valuations, as I mentioned before, they have to be kept up to date. With large property, we don't see annual revaluations. We typically see revaluations every three years, but you need to be conscious of what's going on in the environment in the economy. If prices are moving rapidly in the economy as a consequence of deflation or inflation, and particularly in asset class inflation, then you need to consider whether or not you have to actually revalue more frequently to ensure that the carrying amount doesn't differ materially from the fair value. This was a thing that I really wanted to highlight too because this is an area where people sometimes get caught up is the

idea of the class. Where an item of PPE is revalued, so if you decide that you want to put one item of PPE on the revaluation model, you have to do that for the entire class to which it belongs.

You can't cherry-pick within a class particular assets to fair value. If your policy is to, for example, fair value land, then you have to do it for all land. You can't just do it for some land and not for others. The idea there is obviously there's a protective feature where the standard set is trying to avoid entities, picture picking profit and losses, avoiding revaluing the land that they know is going down in value, and only revaluing land that's going up in value. Same with any other items. The idea is that you need to be consistent to your policy. The other thing I want to highlight there is the idea that it's by nature and use. When I think about classes of assets, I'm thinking about nature, so land, land of buildings, and use. Some machinery might be cleaning machinery, some might be productive machinery. Now, that could be two different classes because they have different use, but if I have machinery that's for production, I don't make a distinction between machinery. It's got located in Australia and a machinery located perhaps in New Zealand.

If it has the same nature and use, then it's in the same asset class if I'm consolidating those two numbers. That's important. Often people do sometimes make mistakes around class and don't understand exactly what they're doing, and the idea is obviously, if you nominate a particular item for revaluation and it's a new item and you've got a pretty existing class, the argument would be is you have to actually reclassify the entire class of that asset to the revaluation model. The other thing I would highlight, and I have seen a little bit of it around, is that once you enter into revaluation models, generally, and again, I have seen some limited variation in thinking on this, but typically, once you move to a revaluation model, you can't really move back to a cost model. The argument is to be is if that's a voluntary choice in accounting policies, the movement back from revaluation to cost does not provide more relevant information.

It might provide as reliable, but it doesn't provide more relevant, and therefore if you move from cost to revaluation, yep, you can make the arguments properly providing more relevant information, but a moving back from remeasurement to... Actually, from revaluation to cost doesn't necessarily give you more relevant information. Consequently, typically once you make that choice to move to revaluation model, you are on that model going forward. Subsequent accounting, issues that we often see, incorrectly capitalising costs for repairs and maintenance or actually expensing enhancements. The main issues we see is probably around the revaluation model. The cost model is usually... I think most people generally get it pretty right. Using an income approach is one thing or a cost approach when comparable market sales data is available. Pardon me. Typically, we see in valuation approaches for particularly property, maybe not so much for maybe plant, but particularly for property, we often see and we've often liked to see triangulation in the valuation, so seeing both an income and recent market sales data as a basis for the fair value.

Again, I mentioned before, assuming the current use is the highest and best use, double counting is another thing we often see, so if a valuer does the value of a property, making sure that maybe they don't count the feedings and fixtures in the valuation as well, particularly if they are separately accounted for on the balance sheet by the owner, so making sure that that's not the case. There might be other situations too with straight lining if you're a lessor, straight lining of the lease incentives and how they're counted or not accounted as a part of the fee value measurement. Allocating items of PPE to the wrong asset class, so excessive aggregation of PPE items. You would typically expect to see land and buildings to be separately accounted for within different classes because typically, building and land's valuations goes in different directions, and not remeasuring PPE on sufficiently frequent basis particularly in light of changing economic conditions.

Just to highlight, obviously the fair value can't be materially different from the carrying amount. Depreciation. I'll skip through these because they're all pretty straightforward. We should all know exactly what depreciation is. We're basically allocating the cost of the period of use of an asset, so go back to the definition of PP&E. It's an asset that provides benefits over more than one year, but we know it's only going to be provided limited benefits.

It doesn't have an indefinite useful life, and so therefore there is a cost associated with its use in each period. We're just allocating it. Components. Do the same with the components. You've got to be able to identify them if they actually are, separately, if they have different life to the asset in which their component they're a part of. You obviously have to depreciate them differently over a different period, and maybe a different pattern as well, subject to the nature of the use.

Commencement of depreciation. Always, again, when the assets in allocation and condition necessary capable for operating for management, and that's at the same time as when the cost cease to be capitalised, and assets should be depreciated regardless whether they're used or idle. Where usage methods used to calculate depreciation will be zero when there's no production, but you would still need to think about actually is the asset impaired if that's the case. Cessation of depreciation, so items of PPE whether held on a cost or revaluation models need to be depreciated on a systematic basis over the useful life except for those that have an unlimited life. Now, land obviously is obvious one. We don't see too many other items of PPE other than land that would be not subject to depreciation and investment properties. Then for depreciation ceases the earlier when the asset's held classified as held sale, it's actually recognised. Looking at a similar, whether it be under the cost or for the revaluation model.

The one thing that we do find is that, typically, people will do their assessment of an asset when they first acquire it, but they don't necessarily do that consistently over the life of the asset because from time to time, you would expect that an asset might have more... Its life might change over time, particularly if it has, I suppose, uneven use over the time or economic environment changes, legal environment changes, and so what you need to be conscious of is the fact that it's not a set and forget scenario, so we can't just sort of say, "Oh, the use for life is X from day one," and just assume that's the case. You need to go back and actually check it every year. This is one area we do find entities get caught out. They don't revisit these assumptions, and as a consequence, they get to a point where they go, "I've got this asset, it has no future economic benefits to me, but I've got a massive balance sitting on my balance sheet," or alternatively, "I'm still using the asset but I've fully depreciated it. I don't know what to do now."

You can get these two weird outcomes, but it really is important to just keep reassessing where you're at with these assets. I think that sort of goes to that point, so idea is that actually, you'd need to review the residual value and the useful life every year. If they change, then it's a change in the estimate and then you do it prospectively. Leasehold improvements, same thing. You might be limited to the lease term subject to whether or not you could take it out of that leased property. It's really a matter of judgement, but then again, you need to apply that constant reassessment of useful life term to be able to understand whether or not you are correctly depreciating your asset over the time. This is another area that I think people should think about too a bit more is that the pattern of depreciation. I'm not talking about the lengths of the useful life or the residual value. What I'm talking about is how is this asset going to benefit me over the future.

Now, none of this is actually subject to scientific experimentation. It's all very much a priority sort of assumptions around how assets work and how they benefit us, and so it's worthwhile maybe sometimes having a bit of a think about how they work because sometimes you can get the same outcomes under the three different methodologies subject to the nature of the asset. Sometimes, you can get very different depreciation amounts under the three approaches subject to the nature of the asset, and so it's worthwhile to think about exactly how the asset's going to be used, what its capacities are, how long is it going to be, how are we going to maintain it, how are we going to use it, how will its benefits change over time subject to how we use it. With straight line depreciation, we're always thinking, "Okay, the asset is just going to give us effectively the same economic benefits over time." Underlying that assumption is the notion that it doesn't matter if we use this more or less, this asset's still going to give us roughly the same economic benefits year by year.

We typically think of property in that line, the idea that it doesn't matter if we're in the building more or less, the building has a life, and eventually, after 80 years, it's probably going to have to be replaced, but every year if we use the building more or less, it doesn't actually change the economic benefits, it doesn't change the useful life, it doesn't change the residual value, it's just the same. Whereas diminishing balance, we are dealing with scenario where we're saying, "No, actually, what'll happen is it really doesn't matter what we do with this asset. We're going to get a lot of benefit out initially and then it'll trail off." Diminishing balance assets too often are ones where you know by the very nature of them that they're valuable upfront, but they provide less and less benefits over time, or units of production. Again, if we expect that the usage of the asset will change its useful life, therefore units of production might be an appropriate way to go because what it's doing is matching to period the use of, and therefore, the economic benefits we got from the asset over that time.

Again, need to be reviewed every financial year. Otherwise, you do get into situations where, "Yep, I've got an asset on my balance sheet, but I know it's effectively physically written off," or "I've got no asset on my balance sheet and I'm still using this asset so it still has economic benefit." They're probably the key ones that we sort of find. I mentioned there what could go wrong. It doesn't reflect the pattern for the asset's future economic benefits, so you can get a real mismatch of... You can not only get a mismatch of pattern of economic benefits but also useful life. If, for example you went, "Oh, I'm going to use unit of production, but in fact it's a straight line, and I did a lot of production upfront, oh, I shouldn't have any asset left, but now I've got to actually think about what I want to do.

Now, I've got an asset that I'm still using, but I've got no asset on my balance sheet." What's specifically prohibited under IAS 16 is depreciation methods that are based on revenue recognition. The reason they're prohibited is because they don't reflect economic benefits. What they're doing is sort of intimately trying to match revenue and costs, so the standard's based on making those things distinct, and again, we don't use the matching principle that much at all in accounting anymore. It's effectively something we've moved away from. The other thing, inputs to the depreciation. You've got to review them manually. I mentioned it before. That's typically probably the main error that a lot of people make. Alison, that brings me to the end of those. I hope I've covered everything and I hope I've covered anyone's questions.

Alison Wood:

Thank you very much, Dean. All right, we will have a look at questions in a second. Just a quick reminder, if anyone else did want to pop a question into the questions box, please do so, and then we can have a quick Q&A. All right, in the interim, I will just run through our upcoming webinars. On the 19th of September, we are looking at Excel basics, also psychosocial safety and risk management, 20 September, SMS strategies for next year, 21st of September, our tax practitioners board session, then we have our tax technical update for the month, and also a cybersecurity update for the month. If you jump on the CCH Learning website, you'll be able to see all the details of those sessions and many more as well. All right, Dean, we'll have a look of just the two questions at the moment. First one here is from Darren. He's just asked, "Given the recent move away from bricks and mortar to an online business model, are you finding preparers are making less errors in accounting for property, plant, and equipment?"

Dean Ardern:

Possibly less errors because they've got less PP&E, but often the ones that have got PP&E, it's a big part of their business, so if they do make a mistake, often the implications are significant. I suppose frequency, maybe they've dropped off a bit, but I suppose the results, the consequences of those mistakes are probably still pretty significant.

Alison Wood:

Makes sense. All right. Trent has the next question here. How would you account for the costs incurred by an entity whose sole purpose is to construct an item of property planner equipment?

Dean Ardern:

Oh, okay. That's a good one. Yeah, you don't see it. No, I was going to say you don't see it so much in the private sector, but you do too sometimes. It's not uncommon to see an entity will set up another entity to construct an asset or to build an asset entirely for them. The principles should be the same. If I paid that entity to construct the asset, then I would pay whatever the costs are that they've incurred, plus maybe a profit margin on that. If I've set that up myself, presumably you'd have to recognise those costs associated with building that thing.

That's interesting because what that does is raises questions about how do I account for say administration? The kind of things I'm thinking of are if you set up a company or set up a company to build something, and that company went and employed people and paid a recruiter to find employees, arguably, that would be the cost that you would incur if you got a contractor to do the same thing for you. That's a good question. I think in principle, you would sort of have to say, well, yeah, whatever costs incurred by the company to build a thing would be capitalised, but I'm not sure if there'd be some diversity in practise around that. I think there'd be probably be some different views, but particularly around general administrative overheads as well.

Alison Wood:

Perfect. Thank you, Dean. Hopefully, that covers the answer for you there. That looks like all the questions that have come through for today's session, so we will just look at closing the webinar off here. In terms of next steps, there will be a feedback survey that pops up for you all. Please take a moment to pop your opinions in there, and shortly after the session today, you'll receive an email letting you know when you can jump into the platform, access the recording PowerPoint. There'll be a transcript and a CPD certificate as well. As always, a question has just popped up right at the end here. Are you okay to cover this one, Dean?

Dean Ardern:

Yeah, sure.

Alison Wood:

Yeah, cool. Jeff's just popped through. What is your suggestion if an item of plant has been fully depreciated but it's still a useful asset when the balance sheet shows no value? Do you value the asset and how do you go about that process?

Dean Ardern:

Oh, it's interesting. Yeah, I think you'd have to make a decision about whether or not that's an error or just an estimate issue, and that's really specific to the asset, so asking yourself, "Well, was there information in the past that could have indicated to me that this thing had a useful life beyond the current period or could I have not even anticipated that? And if that's the case, then I'm in the world of a change in assumption."

I'm a big believer that the balance sheet should show what your resources are that you're using. The standard does anticipate that you might have assets that are fully depreciated, but you're still using them, but I just sort of think that that's a little bit... I don't think that's particularly useful to users and I just don't think it's a particularly truthful description of what the entity's doing, like what it's using and what it's seeing, so I think it would be... It's very specific. It's facts and circumstances type situation, but I would be imagining that the asset should be restated on the balance sheet in some way. How you get it there is really subject to the facts and circumstances.

Alison Wood:

Thank you, Dean. All right. Thank you for that as well, Jeff. Glad we could fit your question in at the end. All right, we will jump back to the end of the slides here, so thank you very much, Dean. Appreciate the presentation and the Q&A there. Thank you to everyone for jumping online. We hope to see you back online for another CCH Learning webinar very soon. Cheers.