



# Accounting and Reporting Policy FRS 102

## Staff Education Note 5 Property, plant and equipment

### **Disclaimer**

This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

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## Introduction

This Staff Education Note provides a comparison of the accounting treatment for tangible fixed assets under current UK accounting standards (including FRS 15 *Tangible Fixed Assets* and FRS 5 *Reporting the substance of transactions*) and Section 17 *Property, Plant and Equipment* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

This Staff Education Note is written to highlight key areas of general application for consideration when transitioning to FRS 102 and is not designed to be exhaustive. In practice, for the majority of entities there are no significant differences in the accounting treatment of tangible fixed assets.

## Recognition criteria for tangible fixed assets

FRS 15 / FRS 5	FRS 102
<p>Does not specifically address recognition criteria for tangible assets. However, FRS 5 <i>Reporting the substance of transactions</i> sets out the general criteria that apply to the recognition of assets which states that an item that meets the definition of an asset should be recognised in the balance sheet if:</p> <ul style="list-style-type: none"> <li>(a) there is sufficient evidence of the existence of the item (including, where appropriate, evidence that a future inflow or outflow of benefit will occur); and</li> <li>(b) the item can be measured at a monetary amount with sufficient reliability.</li> </ul> <p>(FRS 5 paragraph 20)</p>	<p>States an entity shall apply the recognition criteria in determining whether to recognise an item of property, plant and equipment. Consequently, an entity recognises an item of property, plant and equipment when it is probable that future economic benefits associated with the item will flow to the entity, and the costs of the item can be measured reliably.</p> <p>(FRS 102 paragraphs 17.4 and 2.27)</p>

Therefore, FRS 102 explicitly makes the link between an item of property, plant and equipment and the need for future economic benefits to flow to the entity, but this is unlikely to have much impact in practice.

## Initial measurement

### Cost

FRS 15	FRS 102
<p>Requires a tangible fixed asset to be measured initially at cost. Cost includes those costs that are directly attributable to bringing the asset into working condition for its intended use.</p> <p>(FRS 15 paragraphs 6)</p> <p>Examples of directly attributable costs include:</p> <ul style="list-style-type: none"> <li>• acquisition costs;</li> <li>• the cost of site preparation and clearance;</li> <li>• initial delivery and handling costs;</li> <li>• installation costs;</li> <li>• professional fees;</li> <li>• the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision.</li> </ul> <p>(FRS 15 paragraph 10)</p> <p>If the entity chooses an accounting policy of capitalising finance costs, the cost of the construction of a tangible fixed asset may include finance costs.</p> <p>(FRS 15 paragraph 19)</p>	<p>The cost of an item of property, plant and equipment comprises the following:</p> <ul style="list-style-type: none"> <li>(a) its purchase price;</li> <li>(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management including site preparation, initial delivery and handling, installation and assembly, and testing of functionality;</li> <li>(c) the initial estimate of the cost of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period; and</li> <li>(d) any borrowing costs capitalised.</li> </ul> <p>(FRS 102 paragraph 17.10)</p>

In practice there is no difference in the cost that would be capitalised under FRS 15 and FRS 102.

## Subsequent Measurement

### Depreciation and separate components

FRS 15	FRS 102
<p>Requires the depreciable amount of the tangible asset to be allocated on a systematic basis over its useful economic life. (FRS 15 paragraph 77)</p> <p>Notes that the fundamental objective of depreciation is to reflect in operating profit the cost of use of the tangible fixed assets in the period. (FRS 15 paragraph 78)</p> <p>Provides that where the tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life. (FRS 15 paragraph 83)</p>	<p>Requires an entity to allocate the depreciable amount of an asset on a systematic basis over its useful life. (FRS 102 paragraph 17.18)</p> <p>Requires that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. (FRS 102 paragraph 17.16)</p>

Both standards require similar application of a components approach in calculating depreciation; both are based on the consumption of the asset.

### Example

#### Depreciation of major components

On 1 January 20X1, Co A acquired an item of machinery for CU500,000. The machine is made up of two components of equal value; the computer processing unit and the mechanical parts. Management estimate that the computer processing unit has a useful life of 5 years and the mechanical parts have a useful life of 10 years. Management also estimates that the straight-line method best reflects the pattern in which the entity expects to consume the future economic benefits of all components of the machine.

Initially the cost of the machine should be allocated between the two component parts, ie CU250,000 each. Subsequently each component should be depreciated over its respective useful life.

**Residual value**

<b>FRS 15</b>	<b>FRS 102</b>
<p>Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes based on prices prevailing at the date of acquisition (or revaluation).</p> <p>(FRS 15 paragraph 95)</p>	<p>Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement, and changes in market prices may indicate that the residual value or useful life of an asset has changed since the most recent annual reporting date. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life.</p> <p>(FRS 102 paragraph 17.19)</p> <p>Residual value is defined as the estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.</p> <p>(FRS 102 Glossary)</p>

There is a difference in accounting treatment between current UK accounting standards and FRS 102 in the way that residual value is determined. FRS 102 defines residual value as the estimated amount that would currently be obtained ie it takes into account future price changes, whereas FRS 15 does not.

## Revaluations

FRS 15	FRS 102
<p>Permits tangible fixed assets to be revalued only where an entity adopts a policy of revaluation. That policy must be applied to all assets within individual classes of tangible fixed assets, but not necessarily to all classes of tangible fixed assets.</p> <p>(FRS 15 paragraph 42)</p> <p>Where a tangible fixed asset is subject to a policy of revaluation its carrying amount should be its current value as at the balance sheet date. This will be met by a full valuation at least every five years and an interim valuation in year 3. Interim valuations in years 1, 2 and 4 should be carried out where it is likely that there is material change in value.</p> <p>(FRS 15 paragraphs 43 and 45)</p>	<p>After initial recognition, an entity shall measure all items of property, plant and equipment after initial recognition using the cost model or the revaluation model. Where the revaluation model is selected, this shall be applied to all items of property, plant and equipment in the same class.</p> <p>(FRS 102 paragraph 17.15)</p> <p>Provides that under the revaluation model an item of property plant and equipment whose fair value can be measured reliably shall be carried at revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficiently regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.</p> <p>(FRS 102 paragraph 17.15B)</p>

In both cases an option to revalue items of property, plant and equipment is available, however, FRS 15 is more prescriptive with regards to the regularity of valuations (ie full valuations every 5 years and interim valuations every 3 years) however FRS 102 still expects revaluations to be performed with sufficient regularity such that the carrying amount does not differ materially from the fair value at the balance sheet date.

There is also a difference in valuation basis; FRS 15 requires entities to revalue non-specialised properties on the basis of existing use value whereas FRS 102 requires entities to revalue to fair value (which is equivalent to open market value).



## Subsequent expenditure

FRS 15	FRS 102
<p>Subsequent expenditure should be capitalised in three circumstances:</p> <p>(a) where the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance.</p> <p>(b) where a component of the tangible fixed asset that has been treated separately for depreciation purposes and depreciated over its individual useful economic life, is replaced or restored.</p> <p>(c) where the subsequent expenditure relates to a major inspection or overhaul of a tangible fixed asset that restores the economic benefits of the asset that have been consumed by the entity and have already been reflected in depreciation.</p> <p>(FRS 15 paragraph 36)</p>	<p>The entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:</p> <p>(a) it is probable that future economic benefits associated with the item will flow to the entity; and</p> <p>(b) the cost of the item can be measured reliably.</p> <p>(FRS 102 paragraph 17.4)</p> <p>Parts of some items of property, plant and equipment may require replacement at regular intervals (eg the roof of a building). An entity shall add to the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity.</p> <p>(FRS 102 paragraph 17.6)</p> <p>When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.</p> <p>(FRS 102 paragraph 17.7)</p>

FRS 102 does not have an equivalent to paragraph 36(a) in FRS 15. However, in circumstances where subsequent expenditure has been incurred, the basic recognition criteria set out in paragraph 17.4 are still applicable. Therefore, in practice there is unlikely to be any change in accounting treatment as an assessment of the likelihood of future economic benefits occurring will still have to be made before an asset can be recognised.