IPSAS 17 Property, Plant & Equipment – as adopted by the Maltese Government

Guidelines

IPSAS Implementation Team

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Introduction

1. IPSAS 17 Property, Plant & Equipment – as adopted by the Maltese Government

1.1 These guidelines refer to the PP&E accounting standard **as adopted by the Maltese Government**. This version is based on the original IPSAS 17 developed by the International Public Sector Accounting Standards Board (IPSASB). Modifications were made to the original standard to make it more applicable to the local context. A summary of the significant differences with the original IPSAS 17 can be found as an Appendix to the standard, entitled **Comparison with IPSAS 17**.

2. Scope

2.1 These guidelines were prepared to enable the users to:

2.2 Develop a working-level knowledge of the principles contained in the accounting standard; and

2.3 Understand and appreciate the major challenges and benefits resulting from the implementation of IPSAS 17[1].

3. Target Audience

3.1 These guidelines are designed for finance and non-finance employees employed in Ministries and Departments of the Government of Malta.

4. Guidelines Structure

4.1 These guidelines shall provide a detailed overview of all the principles contained in the standard, including PP&E classification, recognition and measurement, depreciation and impairment, derecognition, reporting and disclosure of PP&E information.

[1] References to IPSAS 17 or any other IPSAS shall be taken as meaning 'as adopted by the Maltese Government'.

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A. Property, Plant and Equipment Defined

1. Some assets held by ministries and departments are used for a considerable length of time. These assets may either be Property, Plant and Equipment or Intangible Assets. These Guidelines refer to the former category, Property, Plant and Equipment.

2. Property, Plant and Equipment (PP&E) are physical assets ***controlled and used*** by a ministry or a department for ***more than one*** reporting period, to achieve its goals and implement its objectives.

3. When accounting for PP&Es, the following should be considered:

   - *Is this item an asset?*
   - *What is the item's value?*
   - *How long will it be useful to us?*
   - *Will it have any value after we have finished using it?*
   - *How should we account for the reduction in its usefulness through time?*
   - *How should we show all this in our financial statements?*

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IPSAS 17 defines property, plant and equipment as tangible items that are:

a. held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
b. expected to be used during more than one reporting period.

B. Impact of IPSAS 17 Implementation

1. One of the major differences between the ***current cash-based accounting system*** and ***accruals-based accounting*** is that in the cash-based system PP&E expenses are expensed when there is a cash outlay.

2. For many Central Government entities, PP&E is one of the areas where major implementation challenges are expected both at initial adoption and in subsequent periods. However substantial benefits are expected from the improved accounting and reporting of PP&E that should translate into better decision-making and enhanced oversight. Furthermore, the role of non-finance employees with asset management responsibilities will be even more critical as information maintained in the asset register will directly impact the figures reported on the face of the financial statements.

3. Why adopt IPSAS?

3.1 IPSAS, in particular IPSAS 17, provide information supporting better financial management. The implementation of IPSAS 17 will lead to:

a) Improved overall management and planning, as IPSAS 17 provides information with regards to the value of the asset to the entity, thus enabling the entity to plan and manage its availability of resources over more than one reporting period;
b) Improved accountability and transparency over the use of the assets as a result of enhanced internal control procedures and reporting requirements;
c) Harmonisation of reports and financial statements both within Government and other national Governments and international organisations; and
d) Enhanced credibility, as reports and financial statements will be based on international accounting standards.

3.2 The benefits outlined above can only materialise following a change in the current processes employed by Central Government entities, such as:

a) The identification of PP&E items held by ministries and departments, such as description, location and value;
b) Following identification, the maintenance of these PP&E items, such as physical verifications, impairment tests and reviews of useful lives; and
c) Enhancement of the internal control procedures.

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4. Adopting IPSAS 17 – **what are the challenges?**

4.1 Challenges include:

a) Resistance to change from cash-based to accruals-based accounting;
b) Lack of ownership and inadequate support from top management;
c) Lack of adequate technical resources;
d) Identification and valuation of PP&E assets;
e) Weak internal control systems; and
f) Changes required in information systems – the change from the Departmental Accounting System (DAS) to the new Corporate Financial Management Solution (CFMS), and the use of the respective modules, may be more challenging to poorly staffed ministries and departments.

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C. Classification of PP&E

IPSAS 17 defines a class of property, plant and equipment as a grouping of assets of a similar nature or function in an entity's operations that is shown as a single line-item for the purpose of reporting value and providing disclosure in the financial statements.

1. Central Government entities should disclose PP&E in the ***following eight (11) classes*** in the Notes to the Financial Statements:

1.1 Land and Buildings
1.2 Infrastructure Assets
1.3 Plant and Machinery
1.4 Furniture, Fixtures and Equipment
1.5 IT Equipment
1.6 Vehicles
1.7 Leasehold Improvements
1.8 Assets under construction
1.9 Service Concession assets
1.10 Heritage Assets
1.11 Other non-financial assets[2]

1.1 Land and Buildings

1.1.1 Land

1.1.1.1 Land is defined as the surface or crust of the earth, which may be used to support structures or grow crops, grass, shrubs, and trees. Land is characterised as having an inexhaustible life. All expenditures made to acquire land and to bring it to its intended use should be considered as part of the land cost.

1.1.1.2 **Examples of land cost include**:

a) Purchase price or, if donated, fair market value at time of donation;
b) Commissions;
c) Professional fees (title searches, architect, legal, engineering,

[2] This class shall only be used in specific circumstances, where assets do not fall under classes 1.1 to 1.10, and only following agreement with the pertinent government authority.

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appraisal, surveying, environmental assessments, etc.);

d) Permanent landscaping such as land clearing, excavation, and drainage (including movement of earth in preparation for water impoundment);

e) Demolition of existing buildings and improvements (less salvage);

f) Removal, relocation, or reconstruction of property of others on the land so that the land may be used differently; and

g) Other costs incurred in acquiring the land.

Land clearing costs –part of PP&E land cost

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1.1.2 Buildings

1.1.2.1 A building is defined as a structure that is permanently attached to the land, is partially or completely enclosed by walls, and is not intended to be mobile.

1.1.2.2 **Purchased Building costs** include:

a) Original purchase price;

b) Expenses for reconditioning or altering a purchased building to make it ready to use for the purpose for which it was acquired;

c) Environmental compliance (e.g. asbestos abatement);

d) Professional fees (sales commission, legal, architect, inspection, appraisal, title search, etc.);

e) Cancellation or buyout of existing leases on the building; and

f) Other costs required to place or render the asset into operation.

1.1.2.3 **Construction Building costs** include:

a) Completed project costs;
b) Cost of excavation or grading or filling of land for a *specific building;*
c) Expenses incurred for the preparation of plans, specifications, blueprints, etc.;
d) Cost of building permits;
e) Professional fees (architect, engineer, management fees for design and supervision, legal); *[Note*: Architect fees are expensed if a decision is made to *not* proceed with the construction of the building].
f) Costs of temporary buildings used during and for the construction; and
g) Unanticipated costs such as rock blasting, piling, or relocation of the channel of an underground stream.

Building under construction

1.1.2.4 **Building Improvements and Building Maintenance Expenditure**

1.1.2.4.1 **Building improvements** are defined as capital events that *increase* the *value* of a building and/or *materially extend* the *useful life* of a building.

1.1.2.4.2 **Building Maintenance Expenditure***,* contrary to Building Improvements, is expenditure which allows an asset to continue to be used during its *originally established useful life*. These expenses are NOT capitalised but expensed in the period they are incurred.

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1.1.2.4.3 Examples of **Building Maintenance Expenditure** include:

a) Adding, removing and/or moving of walls relating to renovation projects that are not considered major rehabilitation projects and do *not* increase the value of the building;
b) Improvement projects of *minimal* or *no* added life expectancy and/or value to the building;
c) Plumbing or electrical repairs;
d) Cleaning, pest extermination, or other periodic maintenance;
e) Interior decorations, such as draperies, blinds, curtain rods, etc.;
f) Exterior decoration, such as uncovered porches, decorative fences, etc.;
g) Maintenance-type interior renovation, such as repainting, touch-up plastering, replacement of carpet, tile, or panel sections; sink and fixture refinishing, etc.;
h) Replacement of a part or component of a building with a new part of the same type and performance capabilities, such as replacement of an old boiler with a new one of the same type and performance capabilities; and
i) Any other maintenance-related expenditure which does not increase the value of the building.

Electrical repairs are not capitalised as PP&E

1.1.2.4.4 **Example: Capitalise or expense?**

There may be circumstances where it is difficult to decide. For example, a building having a useful life of 50 years after *25 years* unexpectedly needs its roof to be replaced – once the roof is replaced, should the useful life of the building be extended? *No*, as the replacement of the roof is *not*

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increasing the useful life of the building but avoiding that it is halved. The cost of roof replacement is a maintenance expense as it *maintains* rather than *extends* the originally estimated useful life of the building.

1.1.2.5 Operating Leases on Buildings

1.1.2.5.1 There are Government office buildings currently being occupied under an operating lease agreement. An operating lease is a contract that allows for the use of the building, but does not convey rights of ownership of the said premises. In accordance with IPSAS 13, *Leases* and the guidelines thereof, **an operating lease is not capitalised but accounted for as a rental expense.**

> IPSAS 13 provides accounting requirements for leases. More information on the capitalised costs of PP&E acquired through a lease is provided in the Guidelines on 'Accounting for Leases'.

1.2 Infrastructure Assets

1.2.1 **Infrastructure assets** are normally associated with a network or a system and include:

a) road networks,
b) car parks,
c) lighting systems,
d) water systems,
e) dams and other water storage facilities,
f) public transport infrastructure,
g) electricity supply systems,
h) gas supply systems/networks,
i) pipelines,
j) sewerage systems,
k) cabling and communication systems,
l) ductworks,
m) storm water and drainage systems,
n) retaining walls,
o) parking barriers,
p) fountains,
q) radio or television transmitting tower,
r) signage,
s) wharfs, docks, sea walls, bulkheads and boardwalks; and

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t) street furniture.

Road Networks | Signage | Storm Water System

1.3 Plant and Machinery

1.3.1 **Plant and Machinery** includes machinery and instruments necessary for an industrial or manufacturing operation.

1.3.2 **Examples include**:

a) printing machines at the Government Printing Press,
b) incinerators,
c) palletisers,
d) water tanks, and
e) lifts.

Machinery at the Government Printing Press

1.4 Furniture, Fixtures and Equipment

1.4.1 **Furniture** includes any type of furniture, such as, for example:

1.4.1.1 Office furniture:

a) chairs,

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b) desks,
c) conference tables,
d) filing cabinets, and
e) cupboards,

1.4.1.2 School furniture

1.4.1.3 Hospital furniture

Office Furniture | School Furniture | Hospital Furniture

1.4.2 **Fixtures (and Fittings) include:**

a) built-in bookcases and cupboards,
b) light fittings,
c) network cabling,
d) fixed and demountable partitions,
e) water heaters,
f) extract fans,
g) air-conditioning equipment and systems,
h) joinery,
i) television aerials and satellite dishes,
j) bathroom suites and other sanitary installations,
k) kitchen units,
l) sinks,
m) mirrors,
n) notice boards,
o) lockers,
p) integrated appliances,
q) wall paintings,
r) blinds, curtains and curtain rails,
s) plants and shrubs,
t) ventilation systems,
u) flooring fixed to the floor (such as carpets),
v) security alarm systems,

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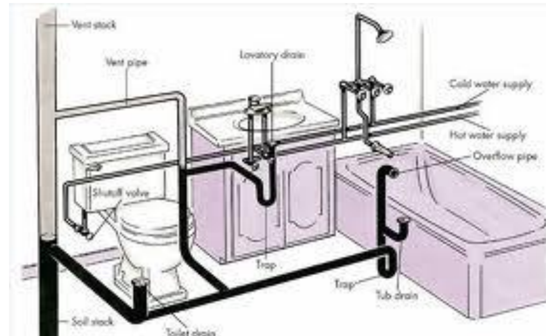
w) solar panels,
x) fire alarm systems,
y) plumbing installations, and
z) central heating boilers and radiators.

Fire Alarm Systems



Plumbing Installations

Partitions

1.4.3 **Equipment** includes any type of equipment, other than IT equipment such as:

a) office equipment (photocopiers, telephone PABX),
b) medical equipment,
c) laboratory equipment,
d) musical instruments,
e) industrial kitchen equipment,
f) tools,
g) military equipment,
h) customs department equipment,
i) fisheries department equipment, and
j) gym equipment.

1.5 IT Equipment

1.5.1 IT Equipment includes:

a) servers,
b) operating systems (when software is an integral part of the related hardware),
c) network appliances,
d) desktop computers,
e) laptop computers,
f) IPads or other transportable technical devices,
g) monitors/screens,

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h) audio visual equipment, including screens, projectors, controllers, microphones,
i) video conferencing equipment including screens, projectors, controllers, microphones, cameras,
j) standalone projectors, and
k) interactive whiteboards.

PCs, Monitors, Keyboards, Laptops

Interactive Whiteboards

1.6 Vehicles

1.6.1 **Vehicles** refer to land vehicles, aircraft, and sea craft, and include:

1.6.1.1 **Motor vehicles (land vehicles):**

a) tractors,
b) ambulances,
c) fork lifters,
d) transport (goods) vehicles,
e) police cars,
f) police segways,
g) police motorbikes,
h) police bicycles,
i) security cars,
j) executive vehicles,
k) military vehicles,
l) fleet cars,

1.6.1.2 **Aircraft**:

a) AFM planes,
b) AFM helicopters,

1.6.1.3 **Seacraft**:

a) AFM inshore/offshore patrol vessels,
b) police boats

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Police car

AFM Patrol Boats and Helicopter

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1.7 Leasehold Improvements

1.7.1 **Leasehold Improvements** refer to alterations made to rental premises in order to customise them for the specific needs of a tenant. In order to qualify for capitalisation, the improvements must be affixed to the property and increase the service potential or the future economic benefit of the asset.

1.7.2 Leasehold improvements include:

a) painting,
b) installing partitions,
c) changing the flooring, and
d) putting in customised light fixtures.

The capitalisation of the above-mentioned leasehold improvements depends on the nature of the expenditure. Refer to **Section D, Recognition of PP&E, sub-section 6 Costs on Recognition.**

Improvements to leased premises

1.8 Assets under construction

There are instances where fixed assets are not acquired in their complete form. Sometimes they are built progressively over a period of time. When Fixed Assets are being built over time, they are treated as assets under construction, and then they are capitalized upon completion. The best approach is to have a separate asset class for assets under construction and during this stage, these assets are not depreciated. Once completed, then the asset is categorized in the proper class of asset and depreciation is recognised. The costs may include:

- Costs associated with buildings under construction
- Costs associated with undeveloped land purchase
- Statutory and design fees
- Costs associated with conditioning land & site development
- Costs with uncompleted IT work.

1.9 Service Concession Assets

1.9.1 Service Concession Asset is an asset used to provide public services in a service concession arrangement.

1.9.2 Service concession assets should be treated as a **separate class of assets** in the statement of financial position. There can be four types:

- ✓ An existing asset of the grantor;
- ✓ An upgrade of an existing asset of the grantor;
- ✓ An existing asset of the operator; or
- ✓ A newly acquired or constructed/developed asset provided by the operator.

[Refer to IPSAS 32, Service Concession Arrangements: Grantor]

1.10 Heritage Assets

1.10.1 Some assets may be described as heritage assets because of their cultural, environmental, or historical significance.

1.10.1.1 **Operational** heritage assets include heritage assets from which future economic benefits or service potential, other than their heritage value, are expected to flow to the entity, such as the Office of the Prime Minister at the Auberge de

Castille in Valletta.

1.10.1.2 **Non-operational** heritage assets' future economic benefit or service potential is limited to their heritage characteristics, such as the Ħaġar Qim temples.

Auberge de Castille: operational heritage asset

Hagar Qim: non-operational heritage asset

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IPSAS Team Decisions

IPSAS 17 distinguishes between the treatment of operational and non-operational Heritage Assets:

- **Operational heritage assets** shall be recognised and measured on the same basis as other items of property, plant and equipment. If the entity can demonstrate that the assets cannot be reliably measured, the entity may, following agreement with the pertinent government body, not recognise these assets, but disclose the description of such operational heritage assets in the Notes to the Financial Statements.

- **Non-operational heritage assets** shall not be recognised, however the Financial Statements shall disclose the description of non-operational heritage assets held by the entity.

If, for example, an operational heritage asset such as Auberge de Castille is no longer used as office premises and retained only for its heritage characteristic, the accounting treatment should be changed and accounted for as a *non-operational heritage asset* and disclosed in the notes to the financial statements accordingly.

D. Recognition of PP&E

IPSAS 17 states that the cost of an item of property, plant, and equipment shall be recognised as an asset if, and only if:

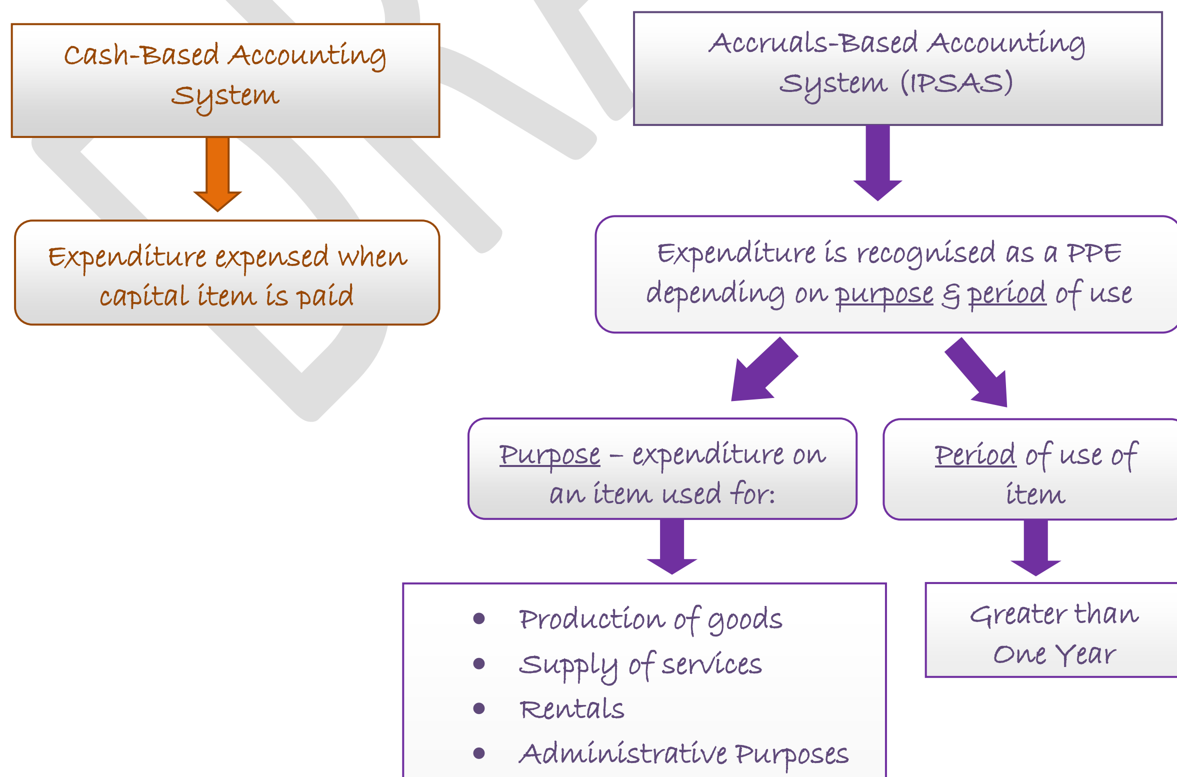
(a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
(b) The cost or fair value of the item can be measured reliably.

1. The **recognition criteria** for any expenditure on property, plant, and equipment to be capitalised as an asset shall be based on the above definition.

2. **Capitalisation** is the recognition of a non-current asset whose costs are systematically charged over the same period in which benefits from that item are to be received.

3. An asset can be **capitalised**, that is recognised as property, plant and equipment (PP&E), when it is expected to be used for more than one period and held:

   a) for use in the production or supply of goods or services,
   b) for rental to others[3], or
   c) for administration purposes.



[3] This guideline does not provide a separate class for assets held for rental since Central Government does not own property having rent as its **primary** scope.

4. Capitalisation Threshold and Low Value Items

IPSAS Team Decisions

Capitalisation threshold Purpose:

- ✓ The purpose of setting a threshold level is to provide the greatest balance between efficiency in administrative effort associated with maintaining proper records for control and the need to expense items, through depreciation, against more than one financial year so that revenues and expenses are matched, as well as the need to present financial information fairly. Setting a threshold is only related to financial reporting and will have no impact on the control of such assets.

Policy - Rule:

- ✓ PPE acquired having a **value greater than €350*** shall be **capitalised**.

*[In the case where the entity is unable to recoup VAT, this is considered as part of the cost of the asset].

- ✓ PPE acquired with a **value equal to or below €350** shall be **expensed** provided that the items purchased are not categorised as Furniture

Exception to rule:.

- ✓ In the case of **Furniture**, all items acquired shall be capitalised irrespective of the value.
  - Furniture has been recognised as a particular category whose exclusion below the threshold will have a major reporting impact on the financial statements published by Government and therefore is being regarded as an exception to the capitalisation threshold rule.

Threshold on acquisition of individual asset:

- ✓ The capitalisation threshold is to be **applied to individual items** even if these are purchased as part of group of homogenous items. Where a group of homogeneous items are purchased at the same time, the individual asset value will be used to determine whether each asset is to be capitalised or expensed.

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- Example: if 6 printers are acquired at a total value of €600 (above the threshold), and each individual printer's value is €100 (below the threshold of €350), each printer acquired should not be capitalised but expensed.

Replacements:

✓ If replacements are part of the **day-to-day maintenance**, these costs should be immediately **expensed**.

✓ Replacement of a component of an asset should be capitalised if:
  - it extends the life of the asset and meets the recognition criteria (as specified below), and
  - the existing asset or component of the asset were previously capitalised as their value was above the threshold, or
  - the existing asset or component of the asset were previously capitalised as they were categorised as a Furniture item (no threshold applicable), or
  - the existing asset or component of the asset were previously not capitalised as they were below the threshold, however the replacement's value is now above the threshold.

Low Value Assets:

✓ Those assets, which were not categorised as Furniture items, and which fall below the threshold and therefore expensed, will still be identified on a Fixed Asset Register strictly for monitoring and control purposes.

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5. PP&E items and Inventory Items:

5.1 Note that one must differentiate between **PP&E items** and **Inventory Items.**

5.2 **Inventory Items** are tangible items that are held for sale, distribution, or consumption in the ***normal course of operations***; they are normally used up during a current operational period, or within a year from their acquisition.

5.3 **Examples:**

a) Spare parts and servicing equipment are usually carried as inventory and recognised in surplus or deficit as consumed. However, *major* spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used *only* in connection with an item of property, plant, and equipment, they are accounted for as property, plant and equipment.

b) Books and other printed material are usually classified as inventory, however library books and reference books should be classified as PP&E if these are expected to be used over more than one period. Similarly, educational books provided by Government which are expected to be used over more than one period should be classified as PP&E.

Spare parts – Inventory

Major Spare part (Engine) - PP&E

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Books - Inventory

Library books – PP&E

6. Costs on recognition

6.1 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include:

a) costs incurred *initially* to acquire or construct an item of property, plant and equipment; and
b) costs incurred *subsequently* to add to, replace part of, or service it (refer to 6.3 below).

6.2 Day-to-day servicing costs – not capitalised:

a) Under the recognition principle mentioned above, an entity does *not* recognise in the carrying amount of an item of property, plant and equipment the costs of the *day-to-day servicing* of the item. Rather, these costs are recognised in surplus or deficit (part of recurrent expenditure) as incurred.
b) Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts**.** The purpose of these recurrent expenditures is often described as for the *"repairs and maintenance"* of the item of property, plant and equipment. These costs include for example, maintenance of a Director's motor vehicle, electricity or plumbing maintenance, lift maintenance and lubricating machines in a printing press etc.

6.3 Major maintenance costs – capitalised:

a) Complex items of PP&E (such as buildings, vehicles and aircraft) may require major maintenance over their useful lives in order to maintain, or to extend, their usefulness. Sometimes such major maintenance is referred to as "overhaul" or "rebuild." Such *major* maintenance is "subsequent expenditure."
b) The cost of replacing *major* components (parts) of an item of

PP&E is *capitalised and added* to the carrying amount of that PP&E. For example, the *changing* of an airplane's engine (and not simply *engine repair*) can be considered as a capital expense as it extends the useful life of the airplane. The carrying amount of any components (significant parts that have been capitalised separately) that are *replaced* is *derecognised*. Therefore, in the case of the airplane, the old airplane engine which has been replaced is derecognised.

6.4 Major inspections costs – capitalised:

a) The cost of *major inspections* or *tests* of an item of PP&E (for example, an aircraft), regardless of whether parts of the item are replaced, is recognised in the carrying amount of that item. Any remaining carrying amount of the cost of a *previous* inspection (as distinct from physical parts) is *derecognised*.

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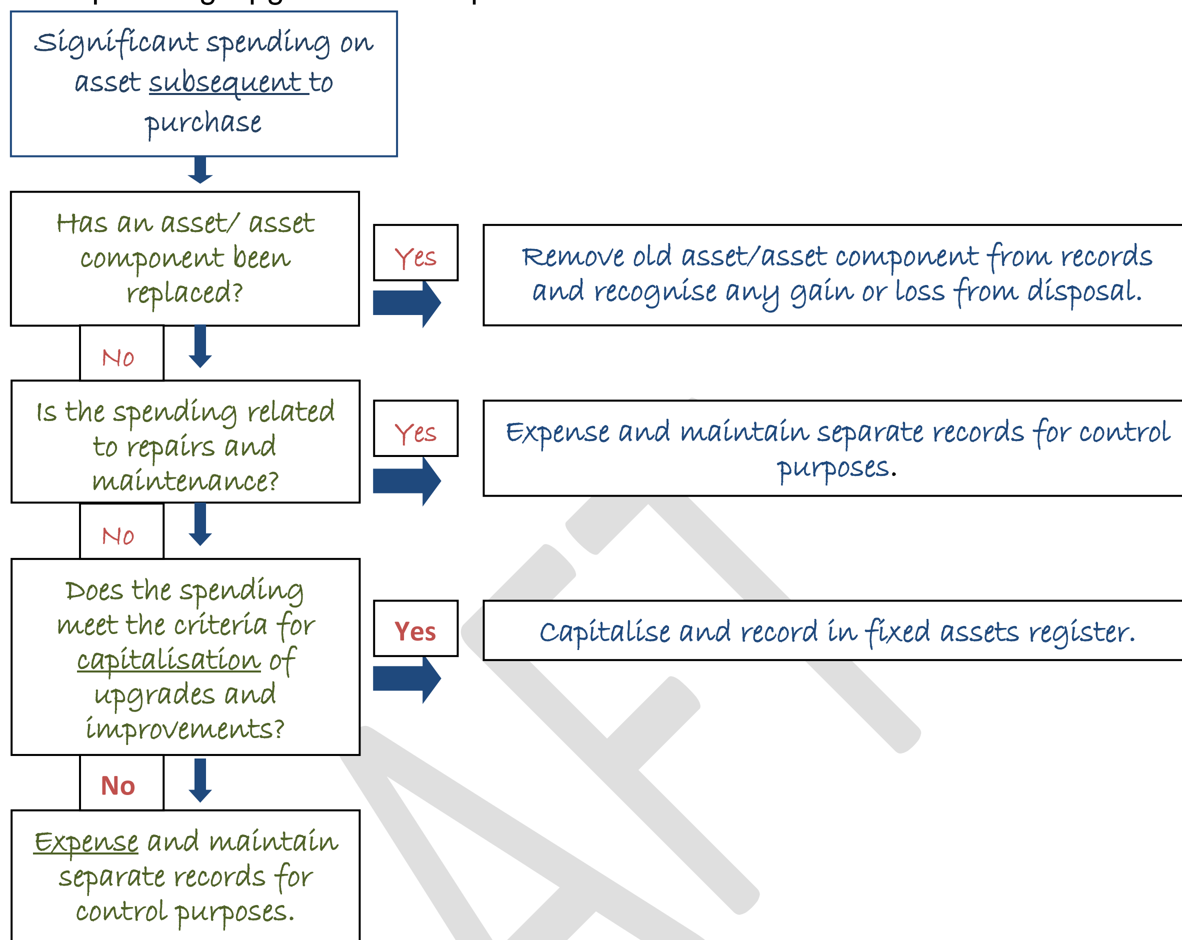
6.5 Capitalising Upgrades and Improvements:



6.6 Examples

a) Example 1

On 1 January 2014 the Government Printing Press purchased an upgrade package at a cost of €60,000 for the machine it originally purchased in 2011. The upgrade took a week to complete, where new components were added to the machine. The department agreed to purchase the package as the new components would lead to a reduction in printing time per unit of 20%. This will enable the department to increase its efficiency without the need to purchase a new machine. Moreover, following the upgrade, the useful life of the machine was re-assessed and consequently increased. Should the additional expenditure be capitalised or expensed?

Solution

The €60,000 should be capitalised as part of the cost of the asset as the efficiency of the machine has significantly increased, which could in turn lead to the inflow of additional economic benefit; furthermore, the useful

life of the machine has also been increased. Note also that the cost of the upgrade can be reliably measured.

b) Example 2

A department has spent €10,000 having the exterior repainted. Should this expenditure be capitalised?

Solution

The department has not enhanced its building beyond its previously assessed state in any way – it has merely incurred maintenance expenditure and as such the cost of repainting the building's exterior should be expensed as 'repairs and maintenance' expenditure.

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E. Measurement of PP&E

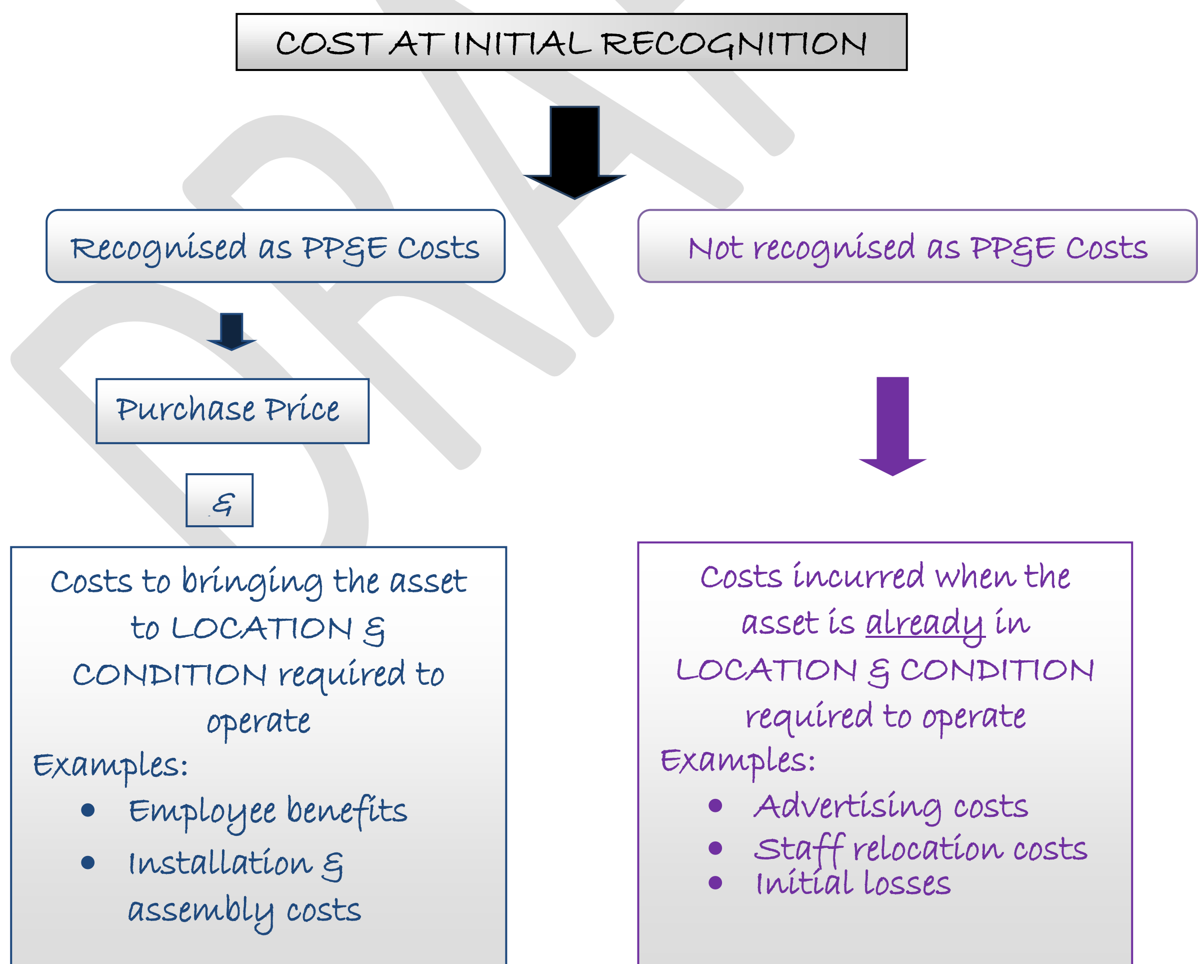
1. Central Government entities acquire PP&E items by means of:

- **Purchase**
- **Lease**
- **Self-construction**
- **Donation**
- **Grant**

2. PP&E Measurement at Acquisition

2.1 **Purchase**

2.1.1 On purchase of a PP&E asset, the costs at initial recognition may not always be eligible for recognition as PP&E costs.



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2.1.2 PP&E costs on purchase include:

a) **Purchase price**, net of any trade discounts plus any import duties and non-refundable sales taxes.

b) Any **costs** directly attributable to bringing the asset to the **location** and **condition** necessary for it to be capable of operating in the manner intended by management. These costs would have been avoided if the asset had not been purchased. Examples of directly attributable costs include:
   i. costs of **employee benefits** (such as wages, salaries etc, as defined in *IPSAS 39, Employee Benefits*) arising directly from the acquisition of the item of PP&E;
   ii. costs of **site preparation**;
   iii. initial **delivery** and **handling** costs;
   iv. **installation** and **assembly** costs;
   v. costs of **testing** whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);
   vi. **professional fees**; and
   vii. **capitalised borrowing costs** on qualifying assets.

c) **Dismantling and removing costs** (initial estimates) of 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.

2.1.3 Land Acquisition Costs

2.1.3.1 Certain costs to acquire an item of land should be included in its capitalised costs upon initial recognition. Costs directly attributable to bringing the land to the condition necessary for it to be used as intended should also be capitalised. These costs include:

a) Title, registration, and other legal fees,
b) Survey costs, and
c) Fees with regards to permission for an intended use.

2.1.4 Costs of Inventories

2.1.4.1 Costs of obligations for dismantling, removing and restoring a site

incurred to produce *inventories* should be accounted for using IPSAS 12, Inventories, and not IPSAS 17.

2.1.5 Costs not recognised as PP&E costs

2.1.5.1 These costs include:

a) Costs of opening a **new facility** (e.g. opening ceremony);
b) Costs of introducing a **new product or service** (including costs of advertising and promotional activities);
c) Costs of conducting business in a **new location** or with a **new class of customers** (including costs of staff training);
d) **Administration** and other general **overhead** costs; and
e) When the item is in the **location and condition necessary** for it to be capable of operating in the manner intended by management therefore costs incurred in *using* or *redeploying* an item are not included in the carrying amount of that item.

2.1.5.2 The following costs are ***not*** included in the **carrying amount** of a PP&E item:

a) Costs incurred while an item ***capable of operating*** in the manner intended by management has yet to be brought into use, or is operated at less than full capacity (for example, a printing machine has been installed by the Government Printing Press and is ready for use, but is not yet being used as the machine's operators are still receiving the required training – the training costs cannot be capitalised);
b) ***Initial operating losses***, such as those incurred while demand for the item's output builds up (for example, during the first year of operations the asset has not yet reached the expected output and therefore the first year of operations was a loss making one – these losses cannot be capitalised); and
c) **Costs of *relocating* or *reorganizing*** part or all of the entity's operations (if the asset is ready for use but needs to be relocated, the associated relocation costs cannot be capitalised).

2.1.5.3 **Incidental operations** may occur before or during the construction or development activities but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. For example, revenue may be earned through using a building site as a car park until construction starts. Because *incidental operations* are *not*

necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognised in surplus or deficit, and included in their respective classifications of revenue and expense.

2.1.5.4 Incidental operations – example

On 1 January 2012 the Government Printing Press acquired a machine for €90,000 with a trade discount of 5% on the retail price. Import duty amounted to €1,000, delivery costs €2,000, installation costs €8,000 and pre-production tests €5,000. The printing press also signed a €12,500 seven-year maintenance contract.

Solution
In accordance with IPSAS 17, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the **cost price** of the asset should be:

Retail Price €90,000 less: trade discount (5%) = €4,500 + import duty €1,000 + delivery costs €2,000 + installation costs €8,000 + pre-production tests €5,000.

Total amount to be capitalised at 1 January 2012: **€101,500.**

The maintenance contract of €12,500 is an expense and therefore should be spread over a seven-year period as expenditure in accordance with the accruals concept.

2.2 Lease

2.2.1 Some departments lease equipment and buildings instead of buying them. When an asset is acquired by means of a finance lease, this lease arrangement may be capitalised.

> IPSAS 13 provides accounting requirements for leases. More information on the capitalised costs of PP&E acquired through a lease is provided in the Guidelines on 'Accounting for Leases'.

2.3 Self-constructed PP&E

2.3.1 The costs of a self-constructed asset are determined using the same

principles as for an acquired asset. Cost includes expenditures that are directly attributable to the construction of the asset.

2.3.2 The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, and the costs of dismantling and removing the items and restoring the site on which they are located.

> IPSAS Decision:
> *Note that borrowing costs shall be recognised as an expense in the period in which they are incurred.*

2.3.3 Self-constructed PP&E: example

a) Construction of the department's new premises began on 1 February 2013. Construction costs included land €6,000,000, architects' fees €950,000, site preparation €3,500,000, materials €8,000,000, direct labour costs €12,000,000, legal fees €2,500,000 and general overheads €1,250,000. The premises were completed on 1 January 2014 and brought into use on the 1 February 2014. What is the amount that should be included as a PP&E cost and what would the impact be on the Statement of Financial Performance for the year ended 31 March 2014?

Solution

This is an example of a self-constructed asset. All costs incurred to get the premises to its present location and condition for its intended use should be capitalised. All of the expenditure listed in the question, with the exception of general overheads, would qualify for capitalisation. Therefore, the amount to be capitalised as PP&E should include:
Land €6,000,000, architect fees €950,000, site preparation €3,500,000, materials €8,000,000, direct labour costs €12,000,000 and legal fees €2,500,000.

Total amount to be capitalised: **€32,950,000.**

General overheads, amounting to **€1,250,000**, should be expensed on the Statement of Financial Performance.

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b) Note that the premises were available for use (therefore in the location and condition necessary for it to be capable of operating in the manner intended by management) on 1 January 2014, therefore depreciation would have been charged to the Statement of Financial Performance.

2.4 **Donated PP&E**

2.4.1 Where an asset is acquired through a non-exchange transaction, such as in the case of a donated asset, its cost shall be measured at its fair value as at the date of acquisition. Fair value is determined by reference to an active market (refer to IPSAS Team Note below).

2.4.2 Donated PP&E results in the recognition of income (less any consideration paid) for the recipient entity in the amount of the fair value of PP&E received provided that a reliable measure of fair value can be made (e.g. donated vehicle recognised as income and the value is based on the market value of the same/similar vehicle). Refer to the provisions of IPSAS 23, Revenue from Non-Exchange Transactions.

2.5 **Grant**

2.5.1 PPE can be acquired through government grants. A government grant is recognised only when there is reasonable assurance that (a) the entity will comply with any conditions attached to the grants and (b) the grant will be received.

2.5.2 The grant is recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis. The approach to be adopted to report a grant relating to assets should be the deferred income approach.

Example: MDH received a government grant of €40,000 to acquire a specialized equipment used for health services. The cost of the equipment is €100,000 and its useful life is 8 years. The department acquired the equipment on 1 July 2019 and recognized depreciation on a straight-line monthly basis.

Solution:

MDH should credit the grant to deferred income and amortize it over the useful life of the equipment in order to match the grant income with the relevant costs (in this case depreciation charges).

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In 2019, MDH recognizes €5,000 in profit or loss (calculated as the grant of €40,000 divided by 8 years).

Journal entries using the deferred income approach are the following:

Debit Bank Account	€40,000
Credit Deferred Income	€40,000
Being recognition of grant income received in advance	

Debit Deferred Income	€5,000 (40 000/8)
Credit Income from Government Grant	€5,000 (40 000/8)
Being the income recognised in P/L.	

<u>IPSAS Team Note:</u>

Non-exchange transactions are transactions in which one entity either receives value from another entity without directly giving approximately equal value in exchange, or gives to another entity without directly receiving approximately equal value in exchange

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Active market is a market in which all of the following conditions exist:

- The items traded in the market are homogeneous;
- Willing buyers and sellers can normally be found at any time; and
- Prices are available to the public.

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3. PP&E Measurement in periods subsequent to Acquisition

3.1 Cost Model

3.1.1 After recognition as an asset, an item of property, plant and equipment shall be carried at its:

a) ***cost***, less
b) any accumulated ***depreciation,*** and
c) any accumulated ***impairment losses***.

3.2 Revaluation Model (only in specific circumstances – refer to 3.3 below)

3.2.1 After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a:

a) **Revalued amount**, being its fair value at the date of the revaluation, less
b) Any subsequent accumulated **depreciation**, and
c) Any subsequent accumulated **impairment losses**.

3.2.2 Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. If a single item of property, plant, and equipment is revalued, then the entire class of property, plant, and equipment to which that item belongs should be revalued.

3.2.3 The *frequency* of revaluations depends upon the *changes* in the *fair values* of the items of the asset. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary.

3.2.4 When an asset is revalued, any *accumulated depreciation* at the date of the revaluation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

3.2.5 The amount of the adjustment arising on the elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with the following two paragraphs:

a) If the carrying amount of a class of assets is **increased** as a result of a **revaluation**, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognised in surplus or deficit to the extent that it reverses a revaluation decrease of the same class of assets previously recognised in surplus or deficit.
b) If the carrying amount of a class of assets is **decreased** as a result of a **revaluation**, the decrease shall be recognised in surplus or deficit. However, the decrease shall be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.

3.2.6 Revaluation increases and decreases relating to individual assets within a class of property, plant and equipment must be offset against one another within that class but must not be offset in respect of assets in different classes.

3.2.7 The **revaluation surplus** included in net assets/equity in respect of an item of property, plant and equipment shall be transferred directly to accumulated surpluses or deficits when the assets are **derecognised**. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through surplus or deficit.

3.3 Cost Model vs. Revaluation Model

3.3.1 An entity shall apply the **cost model** as its accounting policy. The **revaluation model** shall only apply in specific circumstances as determined by the pertinent government body. These circumstances include revaluation of land and buildings owned by Government. The property market frequently experiences an increase in the value of property, and this value needs to be reflected in the carrying amount of the asset.

3.3.2 The chosen policy shall apply to an entire class of PP&E.

3.3.3 Revaluation Model: examples

a) Example 1: a department purchased a property on 1 January 2009 for €3 million. The estimated depreciable amount (the building element) was €1.5 million with a useful economic life of 50 years. Annual depreciation of €30,000 was charged as from 2009 and on 31 December 2013, the carrying amount of the property was €2.85 million [€3 million less (€30,000 x 5)]. On 31 December 2014, the property was revalued to €3.1 million (with an estimated depreciable amount of € 1.8 million and no

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change in useful economic life). Show the treatment of the revaluation surplus and compute the revised annual depreciation charge.

Solution

Revaluation surplus, as at 31 December 2014, in net assets/equity, credited to a revaluation reserve: **€280,000** [€3,100,000 less €2,820,000 (€2,850,000 - €30,000), the carrying amount as at 31.12.2014]
Revised depreciable amount **€1,800,000**
Remaining useful economic life 44years [50 yrs. – 6yrs. (Jan 2009 – December 2014)]
Revised annual depreciation charge **€40,909** [€1.8 million/44years]
[A revaluation usually increases the annual depreciation charge in the Statement of Financial Performance; in the above example, the annual increase is €10,909 (€ 40,909 - € 30,000)].

b) Example 2: the property in example 1 above was revalued on 31 December 2015 and its fair value had fallen to € 2.5 million. Compute the revaluation loss and state how it should be treated in the financial statements as at December 2015.

Solution

Carrying amount at 31 December 2015 **€3,059,091** [€3,100,000 less €40,909 revised annual depreciation].
Revaluation deficit **€559,091** [€3,059,091 less €2,500,000 revalued 31.12.2015].
First offset against Revaluation Surplus €280,000 [refer to amount previously credited to Revaluation Surplus above].
Then charge to Statement of Financial Performance the remaining balance of **€279,091** [€559,091 less €280,000].

3.4 Replacement Cost Method

3.4.1 In cases where there is no open, active and orderly market for certain assets, these should be valued using the replacement cost basis. Often referred to as 'depreciated replacement cost' (DRC), this approach values the asset as the current cost of replacing it with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation. Such assets should be valued on the assumption that the existing use of the asset will continue.

3.4.2 RCM method is also used when there are no proper records to determine the original cost of such asset in order to determine the opening balance, often referred to as the “deemed cost”. A deemed cost will be calculated in the same way as a depreciated replacement cost – that is, the relevant entity will ascertain the (gross) replacement cost of the asset (or a modern equivalent) and then depreciate it to reflect the condition and age of the asset being valued.

3.4.3 Examples where such method could be used is especially when there are specialised buildings such as hospitals, schools, care homes etc., infrastructure assets, and other specialised equipment.

3.4.4 Example 1:
A hospital has an audiometric booth that was bought approximately 7 years ago. The original documentation is no longer available. A modern equivalent booth will cost approximately €4,000. The estimated lifespan of a modern equivalent is 15 years and the relevant hospital specialist estimates that the existing booth will need to be replaced in about 7 years’ time. The opening value of the existing booth is calculated as:

€4,000/15*7=€1,867

3.4.5 Example 2:
The Armed Forces of Malta has an AgustaWestland AW109S helicopter that was donated in the mid-1990s. A modern equivalent would cost about €12 million and would have an estimated useful life of 40 years (suitably maintained). AFM estimates that the AW109S will provide a further 10 years’ service. The opening value of the existing helicopter is calculated as:

€12m/40*10=€3 million

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F. Depreciation

1. **Depreciation** is the **systematic allocation** of the depreciable amount of an asset over its **useful life**. All Items of PP&E, except land and certain heritage assets (e.g. temples), have limited useful lives. Because of this limited useful life, the costs of these assets must be distributed as expenses over the years they benefit.

2. **Depreciation** is the term used to describe the gradual conversion of the costs of the asset into an expense. Periodic repairs and proper maintenance may keep items of PP&E in good operating condition, allowing extraction of the maximum useful life from them, but the recording of depreciation is not eliminated by repairs and maintenance.

3. **Reasons** that cause a **reduction** in the **value** of an asset during its life include:
    a) Usage over the passage of time,
    b) Wear and tear,
    c) Depletion, and
    d) Technological outdating.

4. **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.

5. **Residual value** is the estimated amount that an entity would currently receive 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.

> **Recommended Accounting Practice** is to use a residual value of zero, unless at the end of the asset's usefulness to the department the residual value is likely to be significant.

6. **Useful life is:**
    a) The period over which an asset is expected to be available for use by an entity; or

    b) The number of production or similar units expected to be obtained from the asset by an entity.

6.1 The useful life of an asset is defined in terms of the asset's expected utility to the entity and may sometimes be shorter than its **economic life**.

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<u>**Economic life**</u> is the period that an asset is expected to yield economic benefits or service potential for one or more users.
An item of PP&E may have a <u>useful life</u> that is <u>shorter</u> than <u>economic life</u> – a department might acquire an item of PP&E for a specific project and plan to dispose of it (sell or donate) before the end of its economic life.
Limits such as termination of agreement to use, or expiry date of related leases, causes the useful life of an item of PP&E a department is using to be shorter than its economic life.

6.2 **Examples of factors to consider in determining an asset's expected useful life include:**

a) Expected usage assessed by reference to the asset's expected capacity or physical output.
b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used, the repair and maintenance program and the care and maintenance of the asset while idle.
c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

7. Depreciation of an asset:

a) <u>Begins</u> when it is <u>available for use</u>, that is, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
b) <u>Ceases</u> when the asset is <u>derecognised</u>. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal/sale unless the asset is fully depreciated (for example a department has stopped using a particular machine and although it has been 'retired from active use', it still reduces in value and is still depreciated unless already fully depreciated).

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7.1 Depreciation Method

a) The entity shall apply the straight line method or the units of production method.
b) The entity shall select the method that most closely reflects the expected pattern of consumption of the future economic benefits or service potential embodied in the asset.
c) The entity shall apply the selected method consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

7.1.1 Straight Line Depreciation method

a) The department shall charge a full-year's depreciation expense in the year of acquisition and no depreciation expense in the year in which the asset is classified as held for sale or derecognised.
b) The straight line method depreciates cost evenly throughout the useful life of the fixed asset. Straight line depreciation is calculated as follows:

Depreciation per annum = Depreciable Amount (Cost - Residual Value) / Useful Life

c) Example

An asset has a useful life of 10 years
Cost of the asset is €10,000
Residual Value[4] is €1,000

Depreciable Amount is €10,000 - €1000 = €9,000

Annual Depreciation cost will be **€900** = 9,000 / 10 years

7.1.2 Units of Production Depreciation method

a) The units of production method result in a charge based on the expected use or output.
b) In units of production method, higher depreciation is charged when there is higher activity and less depreciation is charged when there is low level of operation.
c) Zero depreciation is charged when the asset is idle for the whole period.

[4] The recommended accounting practice is to use a residual value of zero; a residual value is being included for the purposes of this example.

d) Life of the asset is estimated in terms of number of operations or number of machine hours, etc. For example, AFM helicopters have a specific number of flying hours before the next major service is required.

e) Depreciation under this method is calculated as follows:

Depreciation per annum =
(No. of units produced / Life in No. of units) x (Cost - Residual Value)

f) Example

An asset has an estimated serviceable life of 5,000 hours.
Cost of the asset is € 200,000.
Residual Value[4] is € 20,000.
Asset ran for 300 hours in the current accounting period.
Depreciation cost = (300 / 5,000) x (200,000 - 20,000)
= 0.06 x 180,000
= € 10,800.

7.2 **Depreciation Rates:** The following are the useful lives and respective depreciation rates applicable to the PP&E assets held by ministries and departments.

The useful lives/depreciation rates which will probably apply to most ministries and departments are the following:

Description of Asset	Useful Life (years)	Depreciation % Rate
Land	n/a	n/a
Buildings	50	2
Plant	15	6.67
Machinery	16.67	6
Furniture & Fixtures & Equipment	10	10
Military Equipment	35	2.86
IT Equipment	4	25
Infrastructure Assets	20	5
Vehicles	5	20
Aircraft	20	5
Seacraft	25	4
Leasehold Improvements	50	2

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7.3 **Accounting Entries:** Double entry involved in recording depreciation may be summarised as follows:

Debit	Depreciation Expense (Statement of Financial Performance)
Credit	Accumulated Depreciation (Statement of Financial Position)

a) At every accounting period, depreciation of an asset charged during the year is credited to the Accumulated Depreciation account.
b) Accumulated depreciation is subtracted from the asset's cost to arrive at the net book value that appears on the face of the Statement of Financial Position.

7.3.1 **Accounting Entries:** Example 1

a) The Government Printing Press purchased a machine costing € 1,200 on 1st January 2011. It had a useful life of three years over which it generated sales of € 2,000 annually. The Government Printing Press' annual costs during the three years amounted to € 900.
b) If the Government Printing Press expensed the entire cost of the machine in the year of acquisition, its Statement of Financial Performance for the three years would be as follows:

Statement of Financial Performance	2011	2012	2013
	€	€	€
Sales	2,000	2,000	2,000
Cost of Sales	(900)	(900)	(900)
Cost of machine	(1,200)	-	-
Net (Deficit)/ Surplus	(100)	1,100	1,100

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c) The Statement of Financial Performance of the Government Printing Press would show a net deficit in the first year, unlike the other subsequent years, even though the sales generated and the cost of sales was constant during this three-year period. Furthermore, although the Government Printing Press earned revenue from machine use over the three-year period, this machine will not appear as a fixed asset on its Statement of Financial Position.

d) If the Government Printing Press capitalised the cost of the machine as a fixed asset and depreciated the cost over three years (the useful life of the asset), its Statement of Financial Performance and Statement of Financial Position would be as follows:

Statement of Financial Performance	2011	2012	2013
	€	€	€
Sales	2,000	2,000	2,000
Cost of Sales	(900)	(900)	(900)
Cost of machine (depreciation)	(400)	(400)	(400)
Net Surplus	700	700	700

Statement of Financial Position (Extract)	2011	2012	2013
	€	€	€
Fixed Assets (machine)	1,200	1,200	1,200
Accumulated Depreciation	(400)	(800)	(1,200)
Net Book Value	800	400	Nil

e) The matching of costs to the corresponding periods of economic benefits presents a more balanced view of the surplus generated by the department.

f) Using the above example, the following double entries will be recorded in respect of depreciation:

Depreciation Expense Account:

Debit			Credit		
2011	Accumulated Depreciation	400	2011	Statement of Financial Performance	400
2012	Accumulated Depreciation	400	2012	Statement of Financial Performance	400
2013	Accumulated Depreciation	400	2013	Statement of Financial Performance	400

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Accumulated Depreciation Account:

Debit			Credit		
2011	Balance c/d	400	2011	Depreciation Expense	400
		400	2011		400
2012	Balance c/d	800	2012	Balance b/d	400
				Depreciation Expense	400
		800	2012		800
2013	Balance c/d	1200	2013	Balance b/d	800
				Depreciation Expense	400
		1,200	2013		1,200

7.3.2 **Accounting Entries:** Example 2

a) A department purchased the following PPE assets with an overall cost of €100,000 on 1 January 2013. These assets consisted of:

   i. Office building including land €65,000 (land element €20,000), estimated useful life 50 years
   ii. Plant & Machinery €11,000, estimated useful life 10 years
   iii. IT Equipment €24,000, estimated useful life 5 years

Calculate the annual depreciation charge for these PP&E assets for the year-end 31 December 2013.

Solution

i. Office building €45,000/50 years = €900 [note – land is not depreciated!]
ii. Plant & Machinery €11,000/10 = €1,100
iii. IT Equipment €24,000/5 = € 4,800
iv. Annual Depreciation Charge = € 900 + € 1,100 + € 4,800 = € 6,800

Note that separate accounts are required to record 'Accumulated Depreciation' for each class of asset.

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G. Impairment

1. **Impairment** is the loss in the future economic benefits or service potential of an asset, over and above depreciation. Impairment reflects a decline in the utility of an asset to the entity that controls it.

> IPSAS 21 / IPSAS 26
>
> To determine whether an item of PP&E is impaired, an entity applies IPSAS 21 or IPSAS 26, Impairment of Non-Cash and Cash-Generating Assets, as appropriate. These Standards explain how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

1.1 Compensation from third parties for items of PP&E that were impaired, lost, or given up shall be included in surplus or deficit when the compensation becomes receivable.

1.2 Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties, and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

a) Impairments of items of property, plant and equipment are recognised in accordance with IPSAS 21 or IPSAS 26, as appropriate;
b) Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
c) Compensation from third parties for items of property, plant and equipment that were impaired, lost, or given up is included in determining surplus or deficit when it becomes receivable; and
d) The cost of items of property, plant and equipment restored, purchased, or constructed as replacement is determined in accordance with this Standard.

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H. Derecognition

1. **Derecognition** of property, plant and equipment is the removal of an item of property, plant and equipment from the Statement of Financial Position.

1.1 Situations determining removal of a PP&E item

1.1.1 An item of property, plant and equipment is removed from the accounts and the Statement of Financial Position when the following situations occur:

a) sale – *used furniture sold following refurbishment of department,*
b) transfer/donation – *vehicle donated to an NGO,*
c) abandonment – *office premises abandoned because of safety risks,*
d) theft – *desk top computers stolen from offices,*
e) destruction – *vehicle destroyed in a car crash,*
f) reported loss – *laptop reported lost during a conference abroad,*
g) asset discrepancy – *unresolved discrepancies during a physical verification exercise.*

1.1.2 PP&E should also be derecognised when no future economic benefits or service potential is expected from it.

1.2 Gains and Losses from Derecognition of PP&E

1.2.1 Gains or losses from derecognition of property, plant and equipment are included in the surplus/deficit in the period the item is derecognised.
1.2.2 Gains from derecognition are not included in revenue from normal operations; they are recognised as a separate line item reported on the Statement of Financial Performance.
1.2.3 The following formula summarises how gains or losses from derecognition are calculated:

Gain/Loss from Derecognition =
Net Disposal Proceeds – Carrying Amount

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1.2.4 Derecognition - example

a) An asset that originally cost € 20,000 and had accumulated depreciation on it of € 11,000 was disposed of during the year for € 8,000 cash. How should the disposal be accounted for in the financial statements?

Solution

The asset and its associated depreciation should be removed from the Statement of Financial Position and a gain or loss on disposal should be recorded in the Statement of Financial Performance:

The loss on disposal is:
Carrying value at disposal date (€ 20,000 – € 11,000) = € 9,000
Disposal proceeds € 8,000
Loss on disposal € 1,000

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I. Disclosure and Reporting of PP&E

1. IPSAS 17 provides that the disclosures concerning property, plant and equipment must be made in the following components of the financial statements:

a) **Statement of Financial Position**

i. Shows all items of assets and liabilities as at the end of the financial period and shows a breakdown of the net asset position.

ii. At the end of the reporting period, the total of the carrying amount of all PP&E is shown as a "Non-current Asset" in the Statement of Financial Position.

iii. The different classes of PP&E are only visible in the Notes, not on the face of the Financial Statements.

iv. Comparative figures (previous year amounts) will not be provided in the first year of IPSAS compliance but reconciliation between beginning and ending balances of PP&E is still required in the Notes to the Financial Statements.

v. The following extract illustrates how PP&E should be reported on the face of the Statement of Financial Position:

Statement of Financial Position as at 31st December 2013 (extract)				
	Notes	2013 (€)	2012 (€)	
Receivables from Exchange Transactions		X	X	IPSAS 1.88 (h)
Investments		X	X	IPSAS 1.88 (e)
Property, plant and equipment	40	X	X	IPSAS 1.88 (a)
Intangible assets		X	X	IPSAS 1.88 (c)

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b) **Statement of Financial Performance:**

i. Shows all items of revenue and expenditure recognised in a financial period and the surplus or deficit of total revenues against expenditure.

ii. Disclosure in the Statement of Financial Performance related to PP&E usually includes **depreciation and impairment losses** in the "Expenditure" section (if material, impairment losses can be shown as a separate line item as "Other gains or losses" as in the example below).

iii. Gains from sale of PP&E shall not be classified as revenue.

iv. The following extract illustrates how PP&E should be reported on the face of the Statement of Financial Performance:

Statement of Financial Performance for the year ended 31st December 2013 (extract)[5]				
	Notes	2013 (€)	2012 (€)	
Expenditure				IPSAS 1.109 - 112
Wages, salaries & employee benefits		X	X	
Depreciation and amortisation expense	25	X	X	
General expenditure		X	X	
Total expenditure		X	X	
Other gains/(losses)				
Impairment loss		X	X	

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[5] This Statement uses the presentation by nature format.

c) **Statement of Cash Flows:**

i. Shows how cash was used by the department during the period, and linking the two previous financial statements.

ii. The following extract illustrates how PP&E should be reported on the face of the Statement of Cash Flows:

Statement of Cash Flows for the year ended 31st December 2013 (extract)				
	Notes	2013 (€)	2012 (€)	
Cash flows from investing activities				IPSAS 2.18, IPSAS 2.31
Purchase of property, plant, equipment and intangible assets		X	X	IPSAS 2.25 (a)
Proceeds from sale of property, plant and equipment		X	X	IPSAS 2.25 (b)
Decrease in non-current receivables		X	X	
Increase in investments		X	X	IPSAS 2.25 (c)
Net cash flows used in investing activities		X	X	

d) **Notes to the Financial Statements**

i. The financial statements shall disclose as notes to the financial statements, for each class of property, plant and equipment recognised in the financial statements:

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- The **measurement bases** used for determining the gross carrying amount;

- The **depreciation methods** used;

- The useful lives or the **depreciation rates** used;

- The **gross carrying amount** and the **accumulated depreciation** (aggregated with accumulated impairment losses) at the **beginning** and **end** of the period;

- A reconciliation of the carrying amount at the beginning and end of the period showing:

    - **Additions**;

    - **Disposals**;

    - **Acquisitions** through entity combinations;

    - Increases or decreases resulting from **revaluations** and from **impairment losses** (if any) recognised or reversed directly in net assets/equity;

    - **Impairment losses** recognised in surplus or deficit;

    - **Impairment losses** reversed in surplus or deficit;

    - **Depreciation**;

    - The net **exchange differences** arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

    - Other changes.

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- The carrying amount of **temporarily idle** property, plant and equipment;

- The gross carrying amount of any **fully depreciated** property, plant and equipment that is still in use;

- The carrying amount of property, plant and equipment **retired from active use** and not held for disposal/sale;

- The amount of property, plant and equipment considered **obsolete** and **written-off** during the financial year; and

- The carrying amount of property, plant and equipment **held for disposal/sale**.

ii. The financial statements shall also disclose for each class of property, plant and equipment recognised in the financial statements:

- The existence and amounts of **restrictions** on title, and property, plant, and equipment pledged as securities for liabilities;

- The amount of expenditures recognised in the carrying amount of an item of property, plant, and equipment in the **course of its construction**;

- The amount of **contractual commitments** for the acquisition of property, plant and equipment; and

- If it is not disclosed separately on the face of the statement of financial performance, the amount of **compensation** from third parties for items of property, plant and equipment that were **impaired**, **lost** or **given up** that is included in surplus or deficit.

iii. The Financial Statements shall also disclose:
   - The description of **non-operational heritage assets** held by the entity, such as monuments, statues and archaeological sites; and
   - The description of **operational heritage assets**, when these assets cannot be reliably measured.

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iv. In accordance with IPSAS 3, an entity shall disclose the nature and effect of a **change in an accounting estimate** having an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:

- **Residual values**;
- The estimated costs of **dismantling**, **removing**, or **restoring** items of property, plant and equipment;
- **Useful lives**; and
- **Depreciation methods**.

v. If a class of property, plant and equipment is stated at **revalued amounts**, the following shall be disclosed:

- The **effective date** of the revaluation;
- Whether an **independent valuer** was involved;
- The **methods** and significant **assumptions** applied in estimating the assets' **fair values**;
- The extent to which the assets' fair values were determined directly by reference to **observable prices** in an **active market** or recent market transactions on arm's length terms, or were estimated using other valuation techniques;
- The **revaluation surplus**, indicating the change for the period and any restrictions on the distribution of the balance to shareholders or other equity holders;
- The **sum** of all **revaluation surpluses** for individual items of property, plant and equipment within that class; and
- The **sum** of all **revaluation deficits** for individual items of property, plant, and equipment within that class.

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Example – extract from the Notes to the Financial Statements

2.2 Summary of significant accounting policies

Property, plant and equipment

(a) Measurement

(i) Land and buildings

Land and buildings are initially recognised at cost.

Land is subsequently carried at the revalued amount less accumulated impairment losses.

Buildings are subsequently carried at the revalued amounts less accumulated depreciation and accumulated impairment losses.

Land and buildings are revalued by independent professional valuers on a triennial basis and whenever their carrying amounts are likely to differ materially from their revalued amounts.

(ii) Other property, plant and equipment

All other items of property, plant and equipment are initially recognised at cost and subsequently carried at cost less accumulated depreciation and accumulated impairment losses.

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(iii) Components of costs

The cost of an item of property, plant and equipment initially recognised includes its purchase price and any cost that is 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.

(b) Subsequent expenditure

Subsequent expenditure relating to property, plant and equipment that has already been recognised is added to the carrying amount of the asset only when it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. All other repair and maintenance expenses are recognised in surplus or deficit when incurred.

(c) Depreciation

Land is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their depreciable amounts over their estimated useful lives based on the following depreciation rates:

	Rate (%)
Buildings	2
Plant & Machinery	15
Furniture & Fixtures & Equipment	10
IT Equipment	25
Infrastructure Assets	10
Vehicles	20

The residual values and estimated useful lives of property, plant and equipment are reviewed, and adjusted as appropriate, at each Statement of Financial Position date. The effects of any revision are recognised in surplus or deficit when the changes arise.

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Notes to the financial statements

40. Property, plant and equipment

	Land & Buildings	Infrastructure Assets	Plant & Machinery	Furniture, Fixtures & Equip.	IT Equip.	Vehicles	Leasehold Improvements	Total	
Cost	€	€	€	€	€	€	€	€	IPSAS
At 1 January 2012	X	X	X	X	X	X	X	X	
Additions	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (i)*
Disposals	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (ii)*
Transfers/adjustment	X	X	X	X	X	X	X	(X	
At 31 December 2012	X	X	X	X	X	X	X	X	*IPSAS 17.88 (d)*
Additions	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (i)*
Disposals	X				X	X	X	X	*IPSAS 17.88 (e) (ii)*
Transfers/adjustments	X	X	X	X	X	X	X	X	
At 31 December 2013	X	X	X	X	X	X	X	X	*IPSAS 17.88 (d)*
Depreciation & Impairment									
At 1 January 2012	X	X	X	X	X	X	X	X	
Depreciation	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (vii)*
Disposals	X	X	X	X	X	X	X	X	
Impairment	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (iv)*
Transfers/adjustment	X	X	X	X	X	X	X	X	
At 31 December 2012	X	X	X	X	X	0	X	X	*IPSAS 17.88 (d)*
Depreciation	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (vii)*
Disposals	X	X	X	X	X	X	X	X	*IPSAS 17.88 (e) (ii)*
Impairment	X	X	X	X	X	X	X	X	
Transfers/adjustment	X	X	X	X	X	X	X	X	
At 31 December 2013	X	X	X	X	X	X	X	X	*IPSAS 17.88 (d)*
Net book values									
At 31 December 2013	X	X	X	X	X	X	X	X	
At 31 December 2012	X	X	X	X	X	X	X	X	

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Glossary

''Accruals-based accounting'' Accruals-based accounting is a system of accounting based on the accrual principal, under which revenue is recognised (recorded) when earned, and expenses are recognised when incurred.

''Asset'' An asset is a resource presently controlled by the entity as a result of a past event and from which future economic benefits or service potential are expected to flow to the entity.

''Asset Management'' Asset management is as a process that directs the procuring, use and disposal of assets to obtain their full potential throughout their lifespan and manages and maintains any costs and risks associated with the assets.

''Carrying amount (aka Net Book Value)'' The carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

''Cash-based accounting'' Cash-based accounting is an accounting method in which income is recorded when cash is received, and expenses are recorded when cash is paid out.

''Central Government Entities (CGEs)'' The term CGEs refers only to ministries and departments of the Government of Malta.

''Class of Property, Plant and Equipment'' A Class of Property, Plant and Equipment is a grouping of assets of a similar nature or function in an entity's operations that is shown as a single line-item for the purpose of reporting value and providing disclosure in the financial statements.

''Depreciable amount'' Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

''Depreciation'' Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

''Derecognition'' Derecognition of PP&E is the removal of an item of property, plant and equipment from the Statement of Financial Position.

''Fair Value'' Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

''Finance Lease'' A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

''Impairment'' Impairment is the loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation. Impairment reflects a decline in the utility of an asset to the entity that controls it.

''International Public Sector Accounting Standards (IPSAS)'' IPSAS are a set of accrual-based accounting standards issued by the IPSAS Board for use by public sector entities around the world in the preparation of financial statements.

''Leasehold Improvements'' A leasehold improvement is an improvement made to a leased building by a lessee that has the right to use this leasehold improvement over the term of the lease. This improvement will revert to the lessor at the expiration of the lease.

''Net Book Value (aka Carrying amount)'' Net Book Value is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

''Non-Operational Heritage Assets'' Non-Operational Heritage Assets are assets having a cultural, environmental, or historical significance and any expected future economic benefits or service potential are limited to their heritage characteristic.

''Operating Lease'' An operating lease is a lease other than a finance lease. In this case the lease does not transfer substantially all the risks and rewards incidental to ownership.

''Operational Heritage Assets'' Operational Heritage Assets are assets having a cultural, environmental, or historical significance and from which future economic benefits or service potential are expected to flow to the entity, as a result of the asset having a functional use for the entity.

''Property, Plant and Equipment (PP&E)'' PP&Es are tangible items that are:

- held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- expected to be used during more than one reporting period.

''Residual value'' Residual value is the estimated amount that an entity would currently receive 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.

‘’Resource’’ A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource.

‘’Service Potential’’ Service potential is the capacity to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

‘’Useful life’’ Useful life is:

- the period over which an asset is expected to be available for use by an entity; or
- the number of production or similar units expected to be obtained from the asset by an entity.

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Amendments to draft Guidelines

Amendments[6] made to the original draft guidelines

Section C [paras 1, 1.1.2.3, 1.1.2.5 *IPSAS Team Decisions*]

Section C [paras 1 – two new classes introduced]

Section D [*IPSAS Team Decisions – capitalisation thresholds*]

Section E [paras 2.2, 2.3.2 *IPSAS Team Decisions,* 2.4 *IPSAS Team Note,* example 3.3.3]

Section E [paras 3.4 *Replacement Cost method*]

Section F [paras 7, 7.1, 7.1.1, 7.1.2, example 7.3.2]

Section F [paras 7.2 Depreciation Rates amended]

Section H [paras 1.2]

Section I [paras 1di, diii]

Glossary [*Operational Heritage Assets]*

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[6] *Only the most significant amendments have been included*