A question for Tom

This month top tutor Tom Clendon tackles a question students frequently ask on international standards

Question

Can you summarise what IAS 16 Property Plant and Equipment is about and explain its revaluation accounting rules?

Answer

IAS 16 Property Plant and Equipment is the standard that regulates how we account for tangible assets that have been bought for use within the business and have an expected life of more than one year. Examples of such assets include office buildings, computers and machinery. Such assets must be depreciated so that their cost is spread over the accounting periods expected to benefit from their use. An exception to this rule is land. This is because land has an infinite life.

The revaluation accounting policy: The standard gives the preparer the choice as to whether such assets are revalued or not. If the accounting policy of revaluation is adopted then the valuations must be kept up to date, all similar assets revalued, and depreciation must continue to be charged on the revalued amount.

In very simple terms, the revaluation gains and losses arising are recognised in equity and reported in other comprehensive income. However, it is possible that revaluation gains and losses are recognised in the statement of profit or loss.

The revaluation rules: This rules as to where revaluation gains and losses on property plant and equipment are recognised and can be summed up as follows: "Gains go to equity unless a reversal of a loss charged to the statement of profit or loss. Losses go to equity until the reserve relating to that asset is exhausted, then losses are charged to the statement of profit or loss."

This is all best understood through an example.

Application of the revaluation rules

Consider land that cost $100 and is revalued to $150, then a year later to $90 and another year later to $125. Let us consider how each revaluation gain or loss would be accounted for.

The first revaluation is $150 and with a cost of $100 there is a gain is $50. All of the gain is recognised in equity and reported in the statement of other comprehensive income.

The second revaluation is $90 and with a carrying value of $150 there is a loss of $60. The first $50 of the loss to recognised in equity and this then exhausts the reserve that relates to that asset. The further loss of $10 is charged to the statement of profit or loss.

The third revaluation is to $125 and with a carrying value of $90 there is a gain of $35. The first $10 of the gain is recognised in the statement of profit or loss as it reverses the loss previously taken there. The remaining $25 gain is then to equity. PQ

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