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Accounting for property, plant and equipment under FRS 102

This briefing note addresses FRS 102's requirements for property, plant and equipment. The same requirements also apply to those investment properties whose fair values cannot be measured reliably or without undue cost and effort: these are expected to be very rare. The requirements for investment properties where fair values are available are addressed in a separate briefing note.

The accounting requirements for PPE under FRS 102 are broadly similar to the existing rules under FRS 15, but there are some one-off options on transition which may appeal to those companies with a portfolio of older properties which are carried at cost.

Definitions

PPE are tangible assets 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 period. This definition excludes heritage assets.

At transition

The transitional arrangements on first adopting FRS 102 are likely to cause the most discussion amongst preparers. The standard gives preparers two key options at transition. These are not available at any other time:

- A previous revaluation under FRS 15 may be taken as 'deemed cost' and frozen. This removes the need for future valuations.
- For assets which have previously been held at historic cost there is the option to revalue to market value at transition and to treat this one-off valuation as "deemed cost". This option may seem attractive to those entities with a portfolio of older properties where depreciated cost may be considerably below market value, or where bank loans are secured on the property as it allows a preparer to match the value of the loan with a current assessment of the property's value. The downside to this is that the higher cost could lead to increased depreciation charges in subsequent years, adversely impacting reported profits and distributable reserves.

FRS 102 requires deferred tax to be provided on all revaluations – this is covered in the note addressing deferred tax in general under FRS 102.

Recognition

An item of PPE shall be initially measured at its cost. Cost, as now, includes the cost of the item together with directly attributable costs that may include legal fees, import duties, inbound transport, site preparation, installation and handling. Borrowing costs may be included as part of the cost of an asset.

The FRS reminds preparers that land and buildings are separable assets, and should be accounted for separately, even when they are acquired together. As such, it will remain helpful if such a split can be determined at, or before, acquisition. The FRS also takes a stronger line on identifying individual components than FRS 15: if the major components of an item of PPE have significantly different patterns of consumption of economic benefits, the total cost shall be allocated over the major components, with each component depreciated separately over its useful life. In practice, identification of individual components probably already happens for most property acquisitions, where identification is critical in maximising capital allowance claims, but producing a reliable allocation of an asset's total cost across its major components could prove challenging in some cases.

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Subsequent measurement

An entity may continue to measure items of PPE at their historic cost less accumulated depreciation and impairment, or adopt a policy of revaluation. If revaluation is chosen then this policy must be applied to all assets in the same class.

Under the revaluation model an item of PPE is recognised at its revalued amount, less accumulated depreciation and amortisation. The frequency of revaluations is notmandated, except for a requirement that revaluations shall be made with sufficient regularity to ensure that the carrying amount reflects the current fair value.

Under FRS 102 "fair value" for a property is its open market value. Companies already adopting a policy of revaluation under FRS 15 are likely to have used existing use value and will, therefore, need to amend their valuation method.

The FRS indicates that revaluations of land and buildings is normally undertaken by someone with a professional qualification, but does not explicitly require this. For assets other than land and buildings open market value as assessed by the directors is normally used, but income-based valuations or depreciated replacement cost may be used for those specialised assets where an open market valuation is not readily available.

Treatment of revaluation movements on PPE

Revaluation gains in excess of original cost are taken to Other Comprehensive Income and are recognised in the revaluation reserve. Unlike revaluation gains on investment property they are not recognised as profit.

Depreciation

Requirements for depreciation and impairment reviews are in line with current UK GAAP.

What companies should be doing now

Companies assess the impact of the policy choices available on transition, particularly whether asset valuations at the transition date may be needed to support the option to take these as deemed cost. Remember that fair value means open market value in the case of property.

For assets acquired after the transition date companies should define the accounting policy for measuring elements of cost, particularly where this involves a change from current policy (e.g. perhaps in relation to borrowing costs) and ensure that systems and documentation capture required information under both the current policy and the FRS 102 policy.

PKF Francis Clark has eight offices in the South West: Exeter, New Forest, Plymouth, Poole, Salisbury, Taunton, Torquay and Truro. Please visit www.pkf-francisclark.co.uk for contact details of your nearest office.