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CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- LKAS 16 – Property, Plant and Equipment

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LKAS 16

Property, Plant and Equipment

DEFINITION

Property, Plant and Equipment 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.
- Are expected to be used during more than one period.

Cost	The amount of cash or cash equivalents paid, or the fair value of other consideration given.
Fair value	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.

RECOGNITION

An item of PPE is recognised when:

- (a) It is probable that future economic benefits associated with the asset will flow to the entity.
- (b) The cost of the asset to the entity can be measured reliably.

"An incorrect initial recognition directly affects future depreciation calculations and reported profits, potentially misleading stakeholders about the entity's financial position. Accurate application of LKAS 16 protects financial statement integrity and provides a reliable basis for subsequent accounting processes. The systematic analysis also creates a defensible audit trail that demonstrates professional judgment in distinguishing capital expenditures from operating expenses."

INITIAL MEASUREMENT

An item of PPE is initially measured at cost. This comprises:

- Purchase price, **including** any import duties paid, but **excluding** any trade discount and sales tax paid.
- Directly attributable costs of bringing the asset to working condition for its intended use.
- Initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located

Purchase Price

The **purchase price** of an asset is not just the invoice amount. Including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

Directly attributable costs

Directly attributable costs are expenditures required to bring an asset to the location and condition necessary for its intended operation. These costs would have been avoided if the asset had not been acquired or constructed.

Directly attributable cost includes	Directly attributable cost excludes
The cost of site preparation	The costs of opening a new facility
Initial delivery and handling costs	Administration, general overheads
Initial delivery and handling costs	Initial operating losses
Professional fees	The costs of staff training
Staff costs arising directly from the construction or acquisition of the asset	The costs of introducing a new product or service (including advertising and promotional costs)
costs of testing whether the asset is functioning properly	Costs incurred while an item is capable of operating in the manner intended by management but is yet to be brought into use

Dismantling and removal costs

An entity may have an obligation to dismantle and remove an asset at the end of its useful life or to put right land affected by the operation of the asset. This obligation may be legal or constructive (whereby an entity has stated publicly that it will dismantle and remove the asset or rectify damage done by it).

In this case, the present value of the expected costs of dismantling, removing and rectification are capitalised as part of the cost of the asset and also recognised as a provision in accordance with LKAS 37.

Dr. PPE	xxx
Cr. Dismantling cost provision	xxx

Question 01

Blue Gem Textiles, a company based in Sri Lanka, purchased a specialised cutting machine from a supplier in Germany. The company incurred several costs related to the acquisition.

Given Information:

- Invoice price of the machine: Rs. 8,000,000
- Trade discount received from the supplier: 5% on the invoice price
- Import duties and non-refundable taxes: Rs. 1,200,000
- Freight and shipping costs to bring the machine to the factory: Rs. 450,000
- Installation and assembly fees paid to engineers: Rs. 300,000
- Costs of testing the machine to ensure it functions correctly: Rs. 75,000
- Professional fees (legal) for the purchase agreement: Rs. 100,000
- Staff training costs for operating the new machine: Rs. 150,000
- General administrative overheads allocated to the purchasing department: Rs. 50,000

Determine the total initial cost to be capitalised on the statement of financial position.

SUBSEQUENT MEASUREMENT

As per LKAS 16 an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

- **Cost Model** – After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment loss
- **Revaluation Model** – After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

DEPRECIATION

Depreciation	Systematic allocation of the depreciable amount of an asset over its useful life.
Depreciable amount	Cost of an asset, or other amount substituted for cost, less its residual value.
Residual value	Estimated amount that an entity would currently obtain from disposal of the asset, after deducting costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Commencement of Depreciation - Depreciation commences when an asset is in the location and condition necessary for it to be used in the manner intended by management.

Cessation of Depreciation – Depreciation ceases when the asset is classified as held for sale in accordance with SLFRS 5 or at the Disposal of the asset. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

'The residual value and the useful life of an asset shall be reviewed at least at each financial year end and, if expectations differ from previous estimates, the changes shall be accounted for as a change in an accounting estimate in accordance with LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors'

USEFUL LIFETIME

Useful life	Either of the following: (a) The period over which an asset is expected to be available for use by an entity (b) The number of production or similar units expected to be obtained from the asset by the entity
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Factors considered when determining the useful life

- Expected usage of the asset
- Expected physical wear and tear
- Technical or commercial obsolescence
- Legal or similar limits on the use of the asset

Question 02 – 2024 December PP

State four (04) factors to be considered when determining the useful life of property, plant, and equipment.

Depreciation Method

The depreciation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. A depreciation method based on revenue generated by the asset is not appropriate.

- The **depreciation method applied to an asset shall be reviewed** at least at each financial year end and, if there has been significant change in expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the change in pattern. Such a change shall be **accounted for as a change in accounting estimates** in accordance with LKAS 8.

Depreciation methods include:

- 1. Straight Line method**
- 2. Reducing Balance method**
- 3. Units of production method**

Straight Line method	Reducing Balance method	Units of Production method
The straight-line method allocates an equal amount of depreciation to each accounting period. This method suits assets that provide consistent benefits throughout their useful life, such as buildings or office equipment.	The diminishing balance method produces a decreasing depreciation charge over an asset's life by applying a constant rate to the carrying amount at each period's beginning. This method used for assets like vehicles or computer equipment where the pattern of economic benefits diminishes as the asset ages.	The units of production method links depreciation directly to an asset's usage rather than the passage of time. This approach matches the depreciation expense with actual economic benefits derived during each period, providing the most accurate cost allocation when an asset's wear correlates with its operational output. This method is used for manufacturing machinery or mining equipment where the asset's life is measured in production capacity rather than years.

Component Depreciation for complex assets

Complex assets often comprise significant parts with different useful lives. LKAS 16 requires each part with a cost significant to the total to be depreciated separately.

Question 03

Wetherby Co purchased a machine on 1 July 2025 for Rs. 500 million. It is being depreciated on a straight-line basis over its useful life of ten years. Residual value is estimated at Rs. 20 million. On 1 January 2026, following a change in legislation, Wetherby Co fitted a safety guard to the machine. The safety guard cost Rs. 25 million and has a useful life of five years with no residual value.

Required to Identify:

What amount will be charged to profit or loss for the year ended 31 March 2026 in respect of depreciation on this machine?

Question 04

A company acquired an asset on 1 January 2024 at a cost of Rs. 500,000, and commenced depreciation immediately on a straight-line basis. The asset was estimated to have no residual value and a useful life of 25 years. After two years, it became apparent that the pattern of consumption of benefits was such that the reducing balance method of depreciation would be more appropriate using a rate of 25%.

Required:

Calculate the depreciation charge in each of the years ended 31 December 2024, 2025 and 2026.

Question 05 – Component Depreciation

ABC Logistics purchases a specialised delivery truck for a total cost of Rs. 8,000,000. The company identifies three significant components. The costs are allocated as follows, with different useful lives for each component. All components have a nil residual value and are depreciated on a straight-line basis.

- **Chassis:** Cost Rs. 4,500,000, Useful Life 10 years
- **Engine:** Cost Rs. 2,500,000, Useful Life 5 years
- **Refrigeration Unit:** Cost Rs. 1,000,000, Useful Life 8 years

Required:

Calculate the total **annual depreciation** expense for the truck.

Question 06

Sanath Holdings owns a building that it purchased for Rs. 50,000,000 with a useful life of 20 years and no residual value. It is depreciated using the straight-line method. At the end of Year 5, the building is revalued to its fair value of Rs. 48,000,000. At the date of revaluation, the remaining useful life is reassessed to be 16 years.

Required:

- (a) **Calculate** the depreciation charge before and after the revaluation.
- (b) **Calculate** the amount of the optional annual transfer from the revaluation surplus to retained earnings.

Question 07 – 2021 July PP

Anora (Pvt) Ltd (Anora) prepares its financial statements in compliance with Sri Lanka accounting standards (LKASs/SLFRSs). The financial year of the company begins on 1 April each year and ends on 31 March the following year. Some of the events of the company that happened with the COVID-19 pandemic are listed below.

- a. The normal production capacity of Anora's manufacturing plant is 320,000 units per month and the fixed production overheads per month are Rs. 80 million. Due to the pandemic, the actual production in March 2020 was limited to 176,000 units.
- b. Due to no physical usage, Anora did not charge depreciation for property, plant and equipment (PPE) during the close down period. The company depreciates its PPE using the straight-line method. It also did not perform an impairment test to assess the recoverability of the carrying value of PPE as at 31 March 2020.

Advise the management of Anora on the accounting treatment for each of the matters referred to in (i), (ii), (iii) and (iv) above for the financial year ended 31 March 2020 in accordance with LKASs/SLFRSs.

Question 08 – 2024 December PP

PMP PLC (PMP) is in the process of preparing financial statements for the year ended 30 September 2024. The finance team has identified the following outstanding financial reporting matters.

Manufacturing sector : PMP Manufacturing (Pvt) Ltd (PMPM) acquired a technologically advanced machine on 1 October 2021 for Rs. 100 million. The

machine was estimated to have a residual value of Rs. 10 million and a useful life of 10 years. On 1 October 2023, the residual value of the machine was reassessed to be Rs. 2 million and the remaining useful life was reassessed to be 4 years.

Required : Demonstrate with numbers how the reassessment of the useful life and residual value should be incorporated in the financial statements of PMPM for the year ended 30 September 2024 (referred to in the manufacturing sector section above).

SUBSEQUENT EXPENDITURE CAPITALIZATION

Assets incur costs after acquisition, and a structured approach is needed to decide whether these **subsequent expenditures** should be capitalised or expensed.

The key principle is **future economic benefits**. If a cost enhances the asset beyond its original performance such as extending useful life, increasing capacity, or improving output quality it should be **capitalised** and added to the carrying amount (affecting future depreciation).

If the expenditure only maintains the asset's current operating condition, it should be **expensed immediately**.

Correct classification is essential to ensure accurate financial reporting. Capitalising routine maintenance overstates assets and understates expenses, while expensing major improvements understates assets and overstates expenses. Proper professional judgment is therefore critical to maintain the integrity of financial statements.

Question 09

Blue Moon Textiles purchased a large industrial machine for Rs. 10,000,000 on 1st January 2021. The machine's main body has a useful life of 20 years. A critical component, the primary motor, was identified at acquisition as having a cost of Rs. 2,000,000 and a useful life of 10 years. The company uses the straight-line method of depreciation.

On 1st January 2026, the original motor fails and is replaced with a new, more efficient motor costing Rs. 2,500,000. The new motor has an expected useful life of 12 years

Required: Account for the replacement of the motor.

Question 10

Sharma Industries Ltd provides the following information relating to its factory building and machinery for the year ended 31 December 2026. You are **required** to classify each expenditure as either **capitalize** as PPE or **expense** immediately.

No.	Description of Expenditure	Capitalize or expense
1	Replacement of roof with higher-quality materials that extend useful life by 10 years	
2	Annual repainting of factory building	
3	Installation of new components in machine increasing production capacity by 20%	
4	Routine servicing of machinery	
5	Major inspection required by regulation to continue operating equipment	
6	Staff training on upgraded production system	
7	Replacement of damaged part restoring machine to original condition	
8	Installation of safety system required by new environmental law	

REVALUATION MODEL

LKAS 16 has strict **requirements** in respect of the application of the revaluation model:

- (1) Where the revaluation model is adopted, it must be applied to an **entire class of assets**. This means that an entity cannot '**cherry pick**' the particular assets that it believes have increased in value and apply the revaluation model to those assets only.
- (2) The revaluation must be kept up to date, such that the carrying amount of an asset **does not differ significantly from its fair value**.

Establishing Revaluation Frequency

Asset values change over time due to market conditions, and outdated valuations can result in carrying amounts that materially differ from fair value. This divergence undermines the relevance of financial statements and can mislead users about the entity's true financial position. An entity must perform revaluations with sufficient regularity to ensure the carrying amount remains a faithful representation of fair value at each reporting date.

The required procedures are:

- Assess assets with volatile fair values for potential revaluation on an annual basis.
- Perform full revaluations at least every three to five years for assets with stable values.
- Conduct annual reviews to identify any indicators of material changes requiring immediate revaluation.



Accounting For Revaluation Results

	Upwards revaluation		Downwards revaluation	
Not previously revalued	DEBIT	PPE	DEBIT	Profit or loss
	CREDIT	OCI (revaluation surplus)	CREDIT	PPE
Previously revalued downwards/ upwards	DEBIT	PPE	DEBIT	OCI (revaluation surplus)
	CREDIT	Profit or loss	DEBIT	Profit or loss
	CREDIT	OCI (revaluation surplus)	CREDIT	PPE
	The credit to profit or loss is equal to the downward revaluation previously recognised in profit or loss.		The debit to OCI is equal to the balance on the revaluation surplus in respect of the asset.	

Revaluation Surplus

A revaluation surplus is recognised as **other comprehensive income** and accumulated in equity in a **revaluation surplus**.

The exception to this rule is where the asset has previous revaluation deficit. In this case, first reverses any revaluation deficit held previously and charged to profit or loss. Any excess is recognised as other comprehensive income.

Revaluation Deficit

A revaluation deficit is treated in the same way as an impairment and recognised in profit or loss.

The exception to this rule is where the asset has previously had a revaluation surplus. In this case, the revaluation deficit is charged to other comprehensive income to the extent that a revaluation surplus exists in respect of the asset. Any excess is recognised in profit or loss.

Question 11

Negombo Exports acquired an office on 1 January 20X5 at a cost of Rs. 200 million and applied the revaluation model to measure it. The fair value of the property was Rs. 220.5 million at 31 December 20X5 and Rs. 210 million at 31 December 20X6. The property has a total useful life of 50 years.

What is the carrying amount of the revaluation surplus in the statement of financial position at 1 January 20X6 assuming that Negombo Exports has not made permitted reserves transfers in respect of depreciation?

Question 12

A company acquired land on 1 January 20X1 at a cost of Rs. 65m. The land was subsequently revalued upwards to Rs. 68m on 31 December 20X4. At the end of 20X7, as a result of a fall in market values, the fair value of the land fell to Rs. 63m. The market recovered in 20X9 and by the end of that year the land had a fair value of Rs. 70m.

Required to Record each revaluation.

DERECOGNITION

The carrying amount of an item property, plant and equipment shall be derecognised:

- a. On disposal
- b. When no future economic benefits are expected from its use or disposal.

The disposal of an item property, plant and equipment may occur:

- a. By sale
- b. By entering into a finance lease
- c. By donation

Disposal Gain and Loss

The profit or loss on the disposal of a non-current asset is the difference between:

- The carrying amount of the asset at the time of its sale, and
- Its net sale price, which is the sales price less any costs of making the sale

A profit is made when the sale price exceeds the carrying amount, and a loss is made when the sale price is less than the carrying amount.

Disposal of revalued asset

Dispose of a revalued asset, any related revaluation surplus becomes realised but cannot be recycled through profit or loss. Identify the revaluation surplus balance relating to the disposed asset and the **related revaluation surplus is therefore transferred to retained earnings**. This is disclosed in the statement of changes in equity.

Question 13 – 2022 December PP

At the board meeting of Tourist Hotels PLC (THP) Group held on 30 June 2021, the following decisions were taken.

A unique Mercedes-Benz car (purchased by THP in 2005), with a carrying value of Rs. 5 million and a revaluation surplus of Rs. 1 million as at 30 June 2021, is to be used as an exhibit item at City Hotel since the repair cost of the vehicle is higher than its possible future economic benefits. Other information

Company policy is to revalue all land and motor vehicles once every 3 years. The last revaluation was carried out as at 31 March 2020 by a professional valuer. He confirmed that there was no significant movement in land prices in 2021 due to the pandemic.

Required:

Propose the journal entries to be recorded in relation to Decision 3 per the requirements of LKAS 16 Property, Plant and Equipment.

DISCLOSURES

For each class of property, plant and equipment, the following must be disclosed.

- a. **Measurement bases** for determining the gross carrying amount (if more than one, the gross carrying amount for that basis in each category)
- b. **Depreciation methods** used
- c. **Useful lives** or depreciation rates used
- d. **Gross carrying amount** and accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period
- e. **Reconciliation** of the carrying amount at the beginning and end of the period showing:
 - Additions, Disposals
 - Acquisitions through business combinations
 - Increases/decreases during the period from revaluations and from impairment losses
 - Impairment losses recognised and reversed in profit or loss
 - Depreciation
 - Net exchange differences (from translation of statements of foreign entity)
 - Any other movements

The **financial statements** should also disclose:

- a. Any recoverable amounts of property, plant and equipment
- b. Existence and amounts of **restrictions on title**, and items pledged as security for liabilities
- c. Accounting policy for **the estimated costs of restoring the site**
- d. Amount of expenditures on account of **items in the course of construction**
- e. Amount of commitments to **acquisitions**

Additional disclosures are required in respect of **revalued assets**. These are:

- a. Basis used to revalue the assets
- b. Effective date of the revaluation
- c. Whether an independent valuer was involved
- d. Carrying amount of each class of property, plant and equipment that would have been included in the financial statements had the assets been carried at cost less accumulated depreciation and accumulated impairment losses
- e. Revaluation surplus, indicating the movement for the period and any restrictions on the distribution of the balance to shareholders