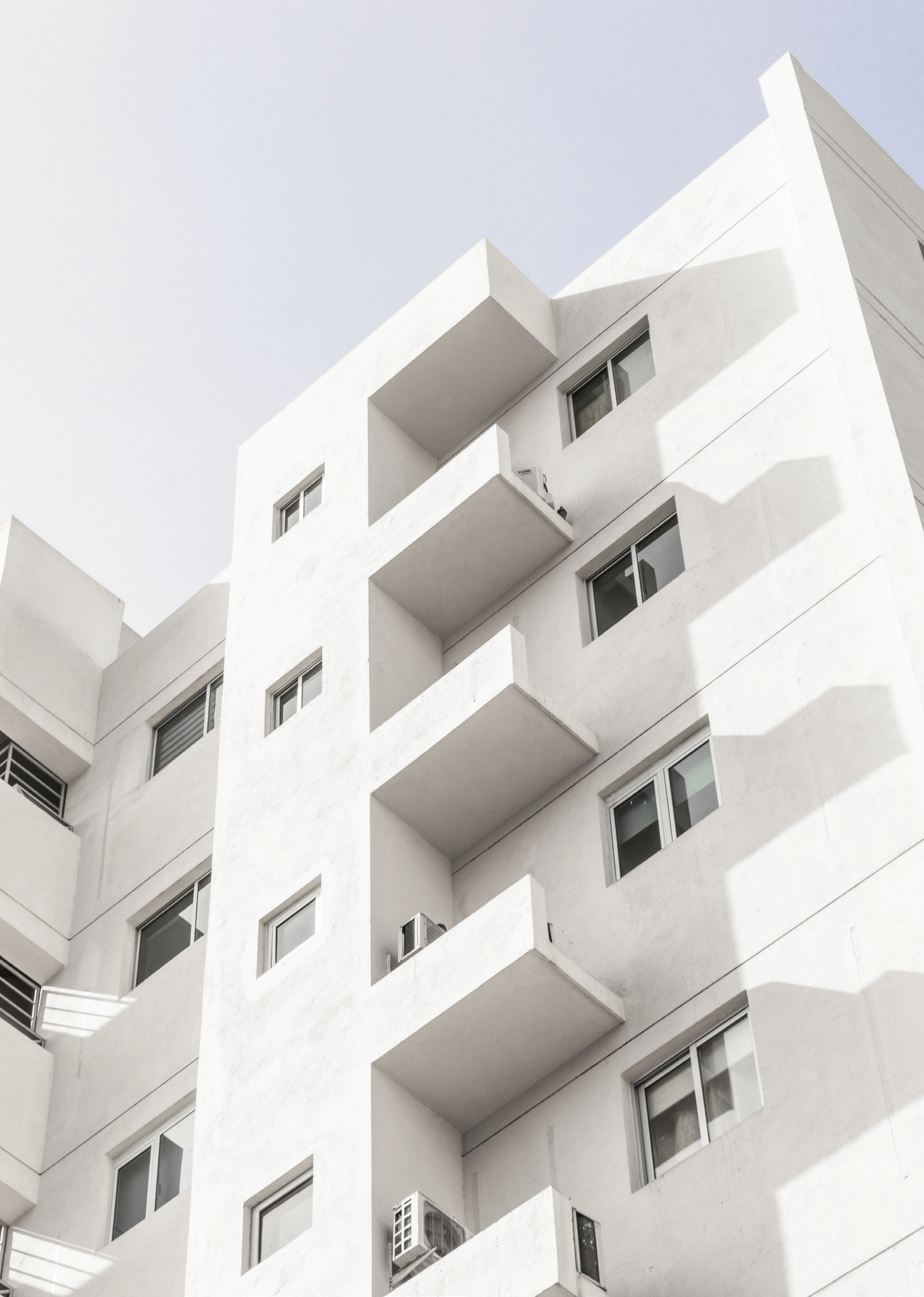
PSASB

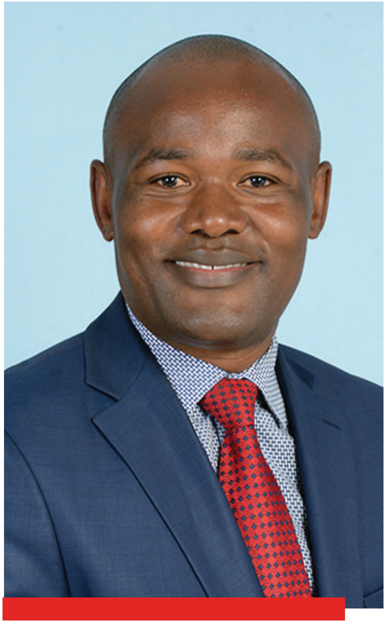
PUBLIC SECTOR ACCOUNTING STANDARDS BOARD (KENYA)

PROPERTY, PLANT AND EQUIPMENT

Guideline, IPSAS 17

2023





MESSAGE FROM THE CEO

Since the gazettement of PSASB in 2014, there has been major improvements in financial reporting. Entities have consistently sought to improve the financial reports that they prepare and submit for audit by the Office of the Auditor General.

Over the years the Board has also continued to issue new financial reporting templates for various sectors majority of which are IPSAS Accrual based templates. Additionally, the Board is looking to transition National and County Government entities reporting on cash basis of accounting to accrual basis of accounting in a bid to enhance accountability and transparency in the public sector.

The developments in reporting requirements have necessitated the Board to come up with innovative ways to disseminate knowledge to the users and preparers of financial statements so as to ensure continuous improvement of the financial reports prepared. The engagements with the preparers of financial statements through various platforms and review of the financial statements through Fire Award has provided an indication of areas where the preparers face challenges in applying standards as they prepare the financial statements.

One of the strategic objectives of the Board is to enhance skills and knowledge in financial reporting. It is on the strength of this objective that this guideline has been prepared so as to act as a guide for the users. IPSAS 17; Property, Plant & Equipment Guideline will be of help to the users and preparers of financial statement as it offers a summarized guide on how to treat PPE.

This guideline is geared to provide a high-level understanding of key concepts on the standard and therefore it is not intended to replace the standard. It is my pleasure to issue this guideline with a view that it will provide more clarity on your understanding and application of IPSAS 17.

CONTENTS

01 Introduction

Public Sector Accounting Standard (IPSAS) 17, "Property, plant and equipment," was issued in December 2001 and revised in December 2006 and should be applied for annual reporting periods beginning on or after January 1, 2008. Since then, the standard has been amended by improvements to IPSAS as well as IPSAS 32,27 and 31.

The objective of this International Public Sector Accounting Standard is to prescribe the accounting treatment for property, plant, and equipment so that users of financial statements can get information about an entity's investment in its property, plant, and equipment and the changes in such investment. The principal issues in accounting for property, plant, and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them.

02 Scope

2.1 Scope of IPSAS 17

An entity that prepares and presents financial statements under the accrual basis of accounting shall apply IPSAS 17 in accounting for Property, plant and equipment except when a different accounting treatment has been adopted in accordance with another IPSAS and in respect of heritage assets.

This Standard applies to property, plant, and equipment including:
- Specialist military equipment.
- Infrastructure assets.
- Service concession arrangement assets after initial recognition and measurement in accordance with IPSAS 32.

This Standard does not apply to:
- Biological assets related to agricultural activity.
- Mineral rights and mineral reserves such as oil, natural gas, and similar non-regenerative resources.

For infrastructure assets.
These are assets which usually display some or all of the following characteristics:
- They are part of a system or network.
- They are specialized in nature and do not have alternative uses.
- They are immovable.
- They may be subject to constraints on disposal.

Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks.

Infrastructure assets meet the definition of property, plant, and equipment and should be accounted for in accordance with IPSAS 17.

For heritage assets IPSAS 17 does not require an entity to recognize them. If it recognises heritage assets, it must then apply the disclosure requirements of this standard and may, but is not required to, apply the measurement requirements of IPSAS 17.

2.2 Definition of Terms

Property, plant and equipment 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 are expected to be used for more than one reporting period.

An asset is a present economic resource controlled by an entity as a result of past events.

An economic resource is a right that has the potential to produce economic benefit to flow to an entity. An asset is not necessarily owned by an entity, but it is controlled by the entity.

Carrying amount is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.

03 Recognition and Measurement

The cost of an item of property, plant, and equipment shall be recognized as an asset if, and only if:

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

Spare parts and servicing equipment are usually carried as inventory and recognized in surplus or deficit as consumed. However, major spare parts and stand-by equipment qualify as property, plant, and equipment if 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.

3.1 Capitalization Threshold

The capitalization threshold is the value above which assets are capitalized and reported in the financial statements as PP&E as opposed to being expensed in the year of acquisition.

The capitalization threshold should not be applied to the components of an asset but should be applied to the value of the capital asset as a whole. If the threshold is applied at component level, the asset register would be incomplete because an asset recorded as such would not be a complete asset.

Note :Asset categorization and Capitalisation threshold in Kenya is guided by the National Assets and Liability Management Policy and guidelines.

3.2 Measurement

IPSAS 17 does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances.

PPE is initially recognized at cost which includes all costs of bringing the asset to its condition of use and location.

The Purchase Price (Includes duties and non-refundable taxes) + Directly attributable cost to bring to location and state of use + Estimated cost of dismantling after use if an obligation exists

PPE Measurement at Acquisition

Cost on Initial Recognition

Recognized as PPE Cost

1. Cost to bringing the asset to location and state of use/ condition required to operate
Examples:
Installation & Assembly cost
Employee Benefits
2. Estimated cost of dismantling the PPE

Not Recognized as PPE Cost

1. Cost incurred when the asset is **already** in location and condition required to operate

Examples:
Advertising cost
Staff relocation costs
Initial losses

Costs recognized as PPE costs on purchase.

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

2. 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:

- 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.
- Costs of site preparation.
- Initial delivery and handling costs.
- Installation and assembly costs.
- 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).
- Professional fees.
- Capitalized borrowing costs on qualifying assets.

3. **Feasibility cost** the cost relating to the preliminary planning and feasibility studies of a project can only be included in the cost of acquisition if it can be reliably measured and if it is probable that a future economic benefit or service potential will flow to the public sector entity. The entity should be able to prove that the project will be undertaken and that the cost is a directly attributable cost of bringing the asset to its working condition for its intended use.

4. **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.

Costs not recognized as PPE costs

Administration and other overhead costs cannot be regarded as directly attributable costs and can therefore not be included in the cost price. As a result, the costs related directly to the administrative process surrounding a tender, such as the tender costs and advertisement costs, cannot be regarded as capital expenses.

These costs include:

- Costs of opening a new facility (e.g. opening ceremony).
- Costs of introducing a new product or service (including costs of advertising and promotional activities).
- Costs of conducting business in a new location or with a new class of customers (including costs of staff training).
- Administration and other general overhead costs.

- 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.

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

- 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 chemotherapy machine has been installed by the Ministry of Health in a County Hospital 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).
- **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).
- 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).
- **Non-qualifying credit costs** - When payment for an asset is above its cash price due to credit terms that are not normal, the amount paid over and above the cash price is recognized as an interest expense over the period of credit and hence not included in the cost of the asset.

Other classes of PPE

1. Leased PP&E

Some departments lease equipment and buildings instead of buying them. When an asset is acquired by means of a finance lease, this lease arrangement is 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'. Please take note that IPSAS 43 will take effect from 1st January 2025.

2. Donated PP&E

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.

Refer to the provisions of IPSAS 23, Revenue from Non-Exchange Transactions.

3. Self-constructed PP&E

The cost of a self-constructed asset is determined using the same principles as for an acquired asset. Cost includes expenditures that are directly attributable to the construction 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.

PP&E measurement after acquisition

After initial recognition an entity can elect to use the following models in measurement in the various classes of PP&E:

1. Cost Model
An item of property plant and equipment shall be carried at its cost, less any accumulated depreciation, and any accumulated impairment losses.

2. Revaluation Model

An item of property, plant and equipment whose fair value can be measured reliably shall be carried at Revalued amount, being its fair value at the date of the revaluation, less any subsequent accumulated depreciation, and any subsequent accumulated impairment losses.

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.

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.

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.

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:

- 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.
- 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.

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.

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 derecognized. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through surplus or deficit.

Cost Model vs. Revaluation Model

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 the revaluation of land and buildings owned by the 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. The chosen policy shall apply to an entire class of PP&E.

3.3 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 cost of these assets must be distributed as expenses over the years they benefit.

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.

Reasons that cause a reduction in the value of an asset during its life include:
- Usage over the passage of time.
- Wear and tear.
- Depletion.
- Technological outdating.

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

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

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.

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.**

Economic life 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 useful life that is shorter than economic life – an entity 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 to be shorter than its economic life.

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

- Expected usage assessed by reference to the asset's expected capacity or physical output.
- 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.
- 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.
- Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Depreciation of an asset:

- Begins when it is available for use, that is, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
- Ceases when the asset is derecognised. 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 hospital 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).

Depreciation Rates

For depreciation rates refer to policies and guidelines from The National Treasury's National Assets and Liability Management.

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

Dr: Depreciation Expense (Statement of Financial Performance)

Cr: Accumulated Depreciation (Statement of Financial Position)

At every accounting period, depreciation of an asset charged during the year is credited to the Accumulated Depreciation account.

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.

Impairment

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.

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.

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.

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:

- Impairments of items of property, plant and equipment are recognised in accordance with IPSAS 21 or IPSAS 26, as appropriate.
- Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard.
- 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.
- The cost of items of property, plant, and equipment restored, purchased, or constructed as replacement is determined in accordance with this standard.

3.4 Derecognition

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

Situations determining removal of a PP&E item

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

i. Sale,
ii. Transfer/donation
iii. Abandonment
iv. Theft
v. Destruction
vi. Reported loss
vii. Asset discrepancy

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

Gains and Losses from Derecognition of PP&E

Gains or losses from derecognition of property, plant and equipment are included in the surplus/deficit in the period the item is derecognised.

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.

The following formula summarises how gains or losses from derecognition are calculated:

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

04 Disclosures

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

1. Statement of Financial Performance:

- Shows all items of revenue and expenditure recognised in a financial period and the surplus or deficit of total revenues against expenditure.
- Disclosure in the Statement of Financial Performance related to PP&E usually includes depreciation and impairment losses.
- Gains from sale of PP&E shall not be classified as revenue.

2. Statement of Financial Position

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

- The different classes of PP&E are only visible in the notes, not on the face of the financial statements.
- 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.

3. Statement of Cash Flows:

Shows how cash was used during the period and linking the two previous financial statements.

4. Notes to the Financial Statements

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

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

2. 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.
- 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.

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

4. 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.
- Depreciation methods.

5. 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.
- The sum of all revaluation deficits for individual items of property, plant, and equipment within that class.

05 Illustrative Examples and Commonly asked Questions

5.1 Examples

Example 1

A public entity acquired a mainframe computer on January 1, (delivery date). The following costs were incurred:
Costs on consultancy helping the entity specify the nature and performance level of the mainframe: Ksh 4,000
Purchase price: Ksh 50,000
Import duties: Ksh 2,000

Transportation expenses: Ksh 3,000
Installation expenses: Ksh 5,000.
The estimated useful life is initially 5 years.
Determine the cost of the computer and the depreciation charge for the year ended 30th June 2016.

Solution

Cost of acquisition (50,000 + 2,000 + 3,000 + 5,000) = 60,000
Cost of acquisition excludes the costs of consultancy because they are not directly attributable to the system that was bought.
Monthly depreciation expense: 60,000 / 60 = 1000
Depreciation expense: 1,000 * 6 = 6000

Example 2

A public entity purchased a property on 1 July 2011 for Ksh 1,500,000, when its estimated useful life was 20 years. On 30th June 2013 the property was revalued to Ksh 1,700,000 and on 30th June 2016 the property was sold for Ksh 1,500,000. What should be recorded in the statement of surplus or deficit for 2016 in relation to the property?

Solution

The property was revalued on 30th June 2013, when the remaining useful life is 17 years.
Annual depreciation after the revaluation is therefore: Ksh. 1,700,000/17 years = Ksh100,000.
At the date of disposal, the net book value of the property is: 1,700,000 – (3x 100,000) = 1,400,000.
Gain on disposal is therefore 1,500,000 – 1,400,000 = 100,000

Cost 1,500,000
Useful life 20yrs
Depreciation = 1,500,000/20 = 7,500,000

Cost 1,500,000
Depreciation for 3yrs (3 x 7,500,000) = (225,000)
NBV 30th June 20x3 1,275,000

Revalued amt 1,700,000
CV at revaluation 1,275,000
Revaluation surplus 425,000

Dr Asset A/C (1,700,000 – 1,500,000) = 200,000
Dr Provision for depreciation (accumulated depreciation) 225,000
Cr Revaluation reserve (1,700,000 – 1,275,000) = 425,000

Depreciation after revaluation = (1,700,000/17) = 100,000
Revalued amt 1,700,000
Depreciation for 3yrs (100,000 x 3) = (300,000)
CV on 30th June 20X6 1,400,000
Gain on disposal = 1,500,000-1,400,000 = 100,000

5.2 Frequently Asked Questions.

How do I determine a property is an investment property if part of it is being used for administrative purposes?

If the portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

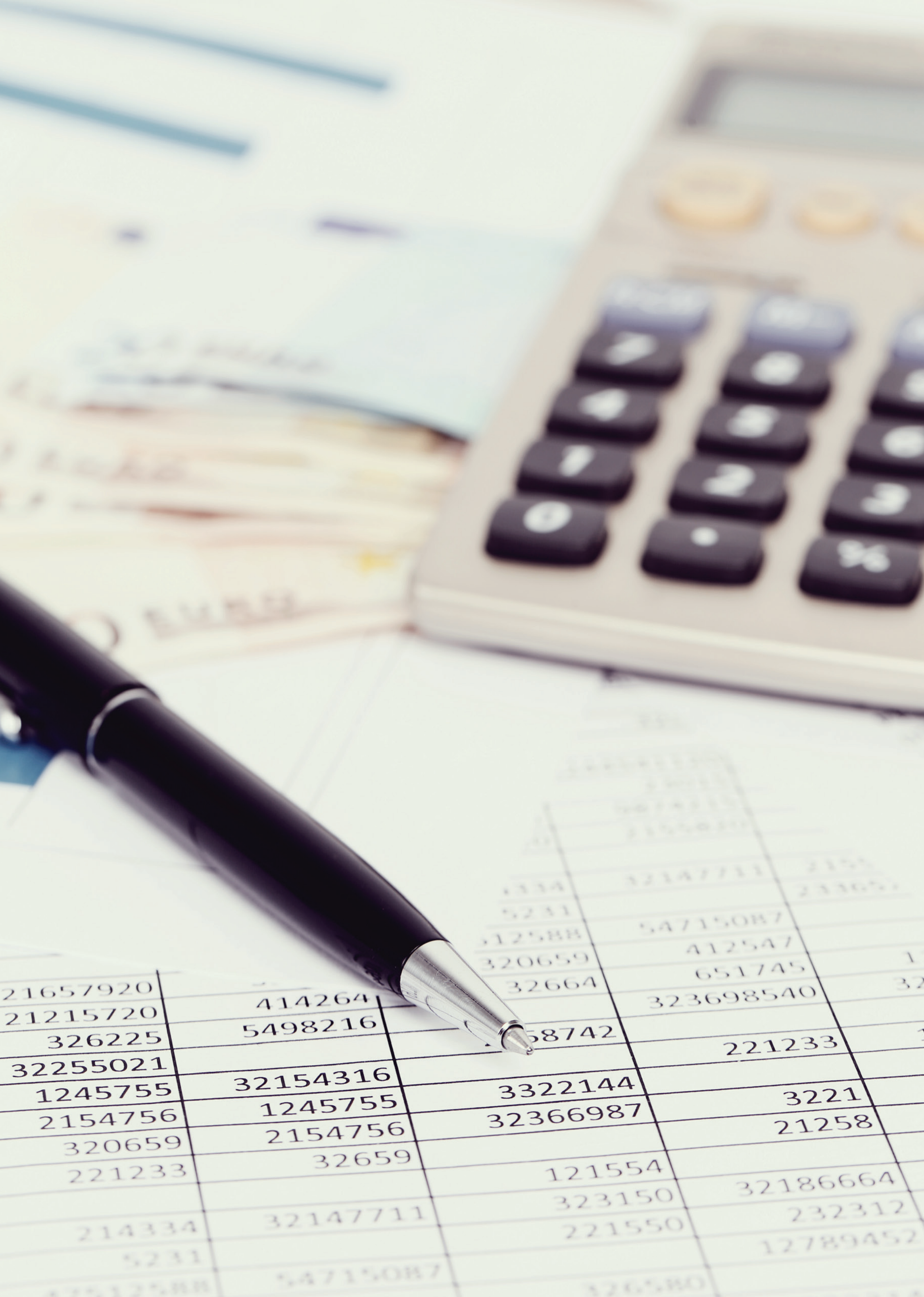
06 Transitional Provisions

Initial Adoption of Accrual Accounting

- Entities are not required to recognize property, plant, and equipment for reporting periods beginning on a date within five years following the date of first adoption of accrual accounting in accordance with IPSASs.

- An entity that adopts accrual accounting for the first time in accordance with IPSASs shall initially recognize property, plant, and equipment at cost or fair value. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition.

- The entity shall recognize the effect of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognized.



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