CHAPTER 9 - REPORTING AND INTERPRETING NON-CURRENT ASSETS

COST OF NCT ASSETS (*proper IFRS terminology is NCT ; called Long-lived or NCT in book)*

- **Cost consists of all costs necessary to acquire the NCT asset and make it ready for its intended use** (i.e. use for production, rental, administration, future…)
  - Cost that benefit future periods are included in the asset account, and are referred to as **capital expenditures**. Capital expenditures include costs that increase the life of an asset or its productivity or efficiency. These costs are normally larger than operating expenditures and occur less frequently
  - Costs which benefit only a current period are expensed, and are referred to as **operating/revenue expenditures**. Operating expenditures are required to maintain an asset in its normal condition and often recur, although not always annually.
  - Difference is not always obvious and impacts NI.

- NCT assets can be subdivided into different categories.

TANGIBLE (also called Property, Plant and Equipment (PPE) or FIXED ASSETS)

Land

Cost = PP (note 1) + legal fees+ survey costs + clearing, demolish, grading, and filling - proceeds from residual materials + betterments+ asset retirement cost (note 2)

Recurring ordinary costs, such as annual property taxes, are recorded as operating expenditures.

Land improvements (structural additions to the land that will decline in service potential, and require maintenance and replacement to keep their value (driveways, fences, sidewalks and parking lots)

Cost = PP + betterments + asset retirement cost

Land improvements are recorded separately from land

Recurring ordinary costs, such as annual painting, are recorded as operating expenditures.

Buildings (can be split in it's different components if material)

Cost = PP (note1) + legal fees + all costs to make the building ready for its intended use (remodelling rooms and offices) + betterments (replacing or repairing the roof, floors, electrical wiring, and plumbing) + asset retirement cost

Ordinary annual repairs that do not extend the life of the building are operating expenditures.

Buildings are depreciated over

Leasehold improvements (by lessee- when building is rented under Operating lease (chap 11))

Cost = PP + betterments + asset retirement cost

Equipment (include: delivery equipment, office equipment, machinery, vehicles, furniture and fixtures)

Cost = PP + freight charges, insurance during transit, assembling, installing and testing costs + betterments + asset retirement cost

Annual costs such as licenses and insurance are operating expenditures

NATURAL OR BIOLOGICAL RESOURCES (i.e. mines; gold, iron, oil, wells, timber, cattle, vineyards, farmland, live hogs *parent* ….)

Cost = PP (if bought) or F - selling costs + betterments + asset retirement cost

INTANGIBLE ASSETS (i.e. GW (note 3), patents, trademarks, copyrights, franchise, technology, licenses, client lists, Development costs from R&D, leasehold from Finance lease (chap 11))

- can be separated from the company and sold separately or based on contractual or legal rights, regardless of whether or not it can be separated from the company

Cost = PP

If have a definite life: amortize SL, If indefinite life: no amortization

Note 1
Purchase price (PP)

- if bought for cash = Invoice price (net of all discounts + all non refundable taxes)
- if bought by issuing debt = Present value of future cash flows (=amount of debt if market interest rate= contractual rate)
- if bought by issuing shares = FV of shares issued
- if in a basket price ; PP of 1 asset = total PP x (MV of 1 asset/ total MV of assets)
- if leased under a Finance lease **=** Present value of future cash flows (see chap 11)
- if not purchased but constructed/built/made internally by the co (and are tangible asset or Technology or Development costs with future benefits)= DM + DL + OH + Interest costs <u>during</u> the construction period can be included in the cost.

Note 2
Asset Retirement Costs = Present value of estimated cost of any obligation to dismantle, remove, clean-up or restore the NCT asset (see chap 11)
Note 3
GW = Unidentifiable asset in an acquisition of another co (business combination/acquisition)
= PP (for the other co) – FV of net identifiable (tangible and intangible) assets
- must be reported separately on SFP

<u>DEPRECIATION (Tangible) /AMORTIZATION (Intangible) / DEPLETION (Natural resources)</u>

- Amortization/Depreciation/Depletion (ADD) is the process of **allocating** the cost of a NCT asset over its useful (service) life in a rational and systematic manner so that expenses are properly **matched** with the pattern in which the asset's future economic benefits are expected to be used. It is **not a process of market valuation**. It represents the decline in physical revenue-producing ability. It does not accumulate cash to replace the asset.
- NCT Assets in SFP = Cost less the accumulated dep. = net book value (NBV) = carrying amount /book value (CV or BV or NCV) but ≠ Fair Value (FV) or market value (MV) (note 4)
- Factors in calculating , need:
  - **Cost**
  - **Useful life**—the period of time over which an asset is expected to be available for use or the number of units of production or units of output that are expected to obtained from an asset.
  - **Residual value (RV)**—an estimate of the amount that a company would obtain from the disposal of the asset at the end of its useful life.

- Depreciation is generally calculated using one of these methods (Amort is SL)
  - **Straight-line** = Depreciable cost (cost – RV) / Useful life (in years /months)
  - **Declining-balance** = CV at beginning of period x rate (= SL rate x 1,5 or 1,75 or 2)
  - **Units-of-production** =
    (Depreciable amount (cost – RV) / useful life (in units of production)) x units produced

Note 4. Under IFRS: two models to account for NCT assets:

- the cost model (only one studied here and only model under ASPE)
- the revaluation model (assets are at FV – studied in later accounting courses)
  where at Y/E difference between CV and FV is recorded in OCI.

Example: Delivery truck purchased by Perfect Pizzas Ltd. on January 1, 20X9:

Cost	$33,000
Expected residual value	$ 3,000
Estimated useful life	5 years
Estimated useful life	100,000 km

Calculation of straight-line Depreciation:

$\frac{\$33,000 - \$3,000}{5 \text{ years}}$ = $6,000 per year (or annual rate of 1/5 = 20%)

Depreciation Schedule assuming Straight-Line Depreciation

Year	Depreciation Expense	Accumulated Depreciation	Carrying Amount
			$33,000
1	$6,000	$ 6,000	27,000
2	6,000	12,000	21,000
3	6,000	18,000	15,000
4	6,000	24,000	9,000
5	6,000	30,000	3,000 = RV
	$30,000		

Depreciation Schedule assuming Double declining-balance method. (rate= 1/5 years = 20% x 2)

1	*2= 4 x 40%*	*3*	*4*
Year	Depreciation Expense	Accumulated Depreciation	Carrying Amount
			$33,000
1	$13,200	$13,200	19,800
2	7,920	21,120	11,880
3	4,752	25,872	7,128
4	2,851	28,723	4,277
5	1,277*	30,000	3,000
	$30,000		

*The asset cannot be depreciated below its RV .

Depreciation Schedule Assuming U**nits-of-production method**:

Cost/km = 33,000 – 3,000 / 100,000 km = $3/km

Year	Activity (Km)	Depreciation Expense	Accumulated Depreciation	Carrying Amount
				$33,000
1	15,000	$ 4,500	$ 4,500	28,500
2	30,000	9,000	13,500	19,500
3	20,000	6,000	19,500	13,500
4	25,000	7,500	27,000	6,000
5	10,000	3,000	30,000	3,000
	100,000	$30,000		

- Management must choose the method that best reflects the pattern in which the asset's future economic benefits are expected to be consumed.
- The Depreciation method must be consistent but must be reviewed at least once a year.

- If the expected pattern of consumption of the future economic benefits has changed, the method must be changed. This is a **change in accounting policies** and F/S must be changed **retrospectively.**
- If the estimates have changed, it is known as a **change in estimate**. The change is made **prospectively** in current and future years but not to prior periods.
- The Canadian Revenue Agency (CRA) allows (optional) corporate taxpayers to deduct a specified amount of **capital cost allowance (CCA**) when calculating taxable income. Income tax regulations require taxpayers to use the single declining balance method (only). The CRA also groups assets into various classes and specifies the CCA rate. Depreciation for accounting purposes is usually different from CCA (which creates **Deferred taxes** in FS).

3. Impairment loss (write-down) is the amount by which the BV of an asset exceeds its recoverable amount (highest of Fair Value (FV) –costs to sell and Value in use (VU)) for ALL tangible and intangible assets.

Carrying amount /BV =$Cost 800,000 – AD $200,000)		$600,000
VU (i.e. PVFCF)	500,000	
FV- costs to sell		550,000
Impairment loss		$ 50,000

JE:

Impairment Loss on equipment	50,000	(+note to FS to explain nature and circumstance)
Equipment	50,000	

- IFRS allow the reversal of a previously recorded impairment loss

4 - Disposal

Wright Ltd. Sells its Office furniture purchased at a cost of $60,000 with Accumulated Depreciation of $33,000 to December 31, 2014. Annual depreciation is $11,000, and the asset is sold July 1, 2015 for $25,000 cash.

1. Update the Depreciation ($11,000 x 6/12 = $5,500):

Depreciation Expense	5,500	
Accumulated Depreciation- Office Furniture		5,500

2. Record the sale:

Cash	25,000	
Accumulated Depreciation*	38,500	
Office Furniture		60,000
Gain on Disposal**		3,500

* $ 33,000 + $5,500 = $38,500

** $ 60,000 – $38,500 = $21,500, $ 25,000 – $21,500 = $3,500 gain.
generally reported in Other rev and exp. or can be exceptional item in Earnings statement

If truck was retired (not sold)

Accumulated Depreciation	38,500	
Loss on retirement	21,500 (=NBV)	
Office Furniture		60,000

RATIO

Fixed Asset (PPE) turnover = Sales / average PPE

If time allows; P 9-2