

LKAS 16 and Componentization

T.M.T.D. Gunasekara & D.K.Y. Abeywardane
thilina.d.gunasekara@gmail.com & dilyapa@kln.ac.lk

Introduction

Mega PLC established on the 1st November 1969. It is empowered to generate electrical energy, transmit the same and distribute it to reach all categories of consumers and to collect the revenue. It is the duty of the Mega PLC to make the optimal use of the resources through the application of pragmatic and time-tested managerial methods in the power and energy sector of Sri Lanka.

Discussion of the Issue

This issue is based on depreciation of asset. Mega PLC has purchased generator on 1st of April 2013 which are including so many parts. These parts (such as Engine, Alternator, Panel Board, and Automatic Voltage Regulator) are embodying in the main asset and individually significant in determining the total cost in relation with generator, but Mega PLC has been depreciated such as a one item. According to LKAS 16 this asset should be depreciated separately.

Implication of the Issue

Mega PLC has not depreciated it separately as part by part. Useful life time of these generators are only 10 years and sub parts have different useful life times and costs as follows.

Following calculations clearly reflects correct depreciation amount.

Total Cost of Generator – 20Mn

Useful life time – 10 Years

Name of parts of Generator	Cost	Useful life time
Engine	8Mn	10 Years
Alternator	8Mn	10 Years
Panel board	2Mn	5 Years
Automatic Voltage Regulator	1Mn	5 Years
Silent canopy	1Mn	5 Years

Depreciation amount charges for year 2013/2014 according to Mega PLC calculation

$20,000,000/10 = 2 \text{ MN}$

Correct depreciation amount for year 2013/2014

Engine – 8,000,000/10 =800,000	}	Total depreciation charge for the year 2013/2014 is; 2.4 MN
Alternator – 8,000,000/10 =800,000		
Panel board - 2,000,000/5 =400,000		
Automatic Voltage Regulator – 1,000,000/5 = 200,000		
Silent canopy - 1,000,000/5 = 200,000		

Income Statement

Due to this issue, depreciation has been understated by 400,000 therefore profit has been overstated by 400,000

Statement of Financial Position

PPE face value of the balance sheet has been overstated by 400,000 because of understatement of depreciation.

Conclusion and Recommendation

Accordingly, Mega PLC should need to be complied with the applicable accounting standards to address recommendations provided for the identified issues and prepare and present its financial statements in a true and fair view in order to meet the expectations of stakeholders.

According to the standard this asset satisfies the following criteria which provided by LKAS 16. (Paragraph 43)

“Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.”

Justification – Should this asset depreciate separately?

<i>Item cost that are significant of the total cost of generator.</i>	Engine, Panel board, Alternator, AVR costs that are significant of the total cost.
<i>Useful life time can be measured reliably</i>	All major parts of the generator have different Useful life time according to the given table.

Above that according to the LKAS 16 such asset should be depreciated separately

Therefore as per above extractions and justifications (all satisfied) from the standard (LKAS 16) these asset should be depreciated separately.

Depreciation Charge for the year

The Company has depreciated on total cost of generator which is 20Mn. But it should be depreciated separately. Therefore depreciation charge for the period has understated. It will lead to increase the profit of the company. So for the period accounting treatments should be adjusted as follows.

Statement of comprehensive income (Dr)	400,000
Provision for depreciation A/c (Cr)	400,000
(Being recorded the under depreciation of PPE)	