Recognition of Non-Current Assets

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Introduction

ABC (Pvt) Ltd. is a member of PQR Group which can be categorized under Service industry. ABC (Pvt) Ltd. offers civil construction, mechanical engineering, electrical engineering and other specialized engineering services.

Company has a separate section which is called as CNC Mold section. It has a large CNC Mold Machine with the special Steel floor and high power supply Transformer. The company considered steel floor and transformer are components of the CNC machine and the company Statement of Financial Position has shown the cost of machine with the cost of steel floor and high power supply Transformer.

Discussion of the Issue

Cost of CNC Mold machine is 3.5Mn. Company builds a special steel floor in the factory building for the purpose of this machine installation. The value of steel floor is 0.5Mn. Company located a high power supply transformer at the same time of machine installation, because this machine needs high voltage power supply. It use to supply power to other machines also. The value of transformer is 1Mn. Useful life of these assets are more than 1 year.

The company considered steel floor and transformer are components of the CNC machine and cost of steel floor & transformer are capitalized to the CNC machine. The company Statement of financial position has shown the total cost of Machine with a value of 5Mn. According to the LKAS 16 and IFRIC 18 this identification is incorrect.

Implication of the Issue

As a result of this issue the Statement of Comprehensive Income and the Statement of Financial Position of the company will be affected in following ways.

- Overstated value of PPE is shown on the face of the statement of financial position.
- Machines are depreciated at the rate of 20%. Machine depreciation shown in the financial statement is 1Mn. Therefore depreciation is overstated in the Statement of Comprehensive Income.
- And also expenses are understated. Because, according to IFRIC 18 Asset transferred from the customer not met the Asset recognition criteria, it can’t be recognized as an asset of the entity. Therefore Transformer cost should be expensed.
Conclusion and Recommendation

- The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful for a wide range of users in making economic decisions. Therefore it should be characterized with understandable, reliable, relevance and comparable.

- Ownership of the Transformer is the company. But controlling power of the Transformer has another company. Though Transformer has useful life time and it is not only in connection with CNC machine, according to the IFRIC 18 “Transfers of Assets from Customers” it should not be capitalized.

  The basic principle of IFRIC 18 is that when the item of PPE transferred from the customer not meets the definition of an asset from the perspective of the recipient, the recipient must not recognize the asset in its financial statements. If the customer continues to control the transferred item, the asset definition would not be met even if ownership of the asset is transferred to other recipient entity. Therefore it is recommended that the value of Transformer cost should not capitalized because it has not met the recognition criteria. Company should identify it as expense.

- Capitalization of steel floor is correct. Because the purpose of steel floor is locate the CNC Machine. But amount of depreciation of steel floor is incorrect. It is depreciated under rate of machine depreciation.

  According to the LKAS 16 (sec: 43) each part of an item of PPE with the cost that is significant in relation to the total cost of the item shall be depreciated separately. Therefore it is recommended that cost of steel floor can be capitalized to the cost of CNC Machine but it should be depreciated under separate rate of depreciation.