Participant’s Guide for CBT - 3 and ILT - 3
Accounting for Property, Plant & Equipment
Training Products to Support THE ADOPTION OF International Public Sector Accounting Standards (IPSAS) by United Nations system Organizations

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List of Abbreviations/Acronyms Used in Course ILT 3

- **CEB**: Chief Executives Board for Coordination
- **ERP**: Enterprise Resource Planning
- **GPFS**: General Purpose Financial Statements
- **IFAC**: International Federation of Accountants
- **IPSAS**: International Public Sector Accounting Standards
- **IPSASB**: International Public Sector Accounting Standards Board
- **IT**: Information Technology
- **Incoterms**: International Chamber of Commerce Terms
- **PP&E**: Property, Plant and Equipment
- **UNSAS**: United Nations System Accounting Standards
Full Suite of IPSAS Courses

The following suite of 7 Computer Based Training (CBT) courses and 11 Instructor Led Training (ILT) courses have been developed to support IPSAS implementation in United Nations system organizations.

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Linkages Between IPSAS Courses

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Course Description and Overview

**Description** - This is an intermediate course to enable participants to:

- Develop a working-level knowledge of principles that guide the IPSAS compliant accounting and reporting for Property, Plant and Equipment (PP&E) and
- Understand the major changes, challenges and benefits related to IPSAS 17.

**Target Audience** - This course is designed for financial and non-financial staff working in and managing areas with significant property, plant, and equipment holdings. The recommended pre-requisites for this course are:

- **Course 1:** Orientation to IPSAS and
- **Course 2:** Accrual accounting under IPSAS: the Basics

**Course Structure** - The course begins with an introduction to property, plant and equipment (“PP&E”) in the United Nations system context and the “business cycle” of PP&E. It will then lead you through the key aspects of accounting for PP&E under IPSAS, contrasting with the current UNSAS practices. The course will lead you through aspects of PP&E classification and measurement, accounting for PP&E use, how to report and disclose important information concerning PP&E. It will give an overview of key audit issues concerning PP&E. Finally, it will summarize key points brought out during this course.

Course Overview

- **Course Overview**
  - **Introduction**
  - **Changes, Benefits and Challenges**
  - **Classification of PP&E**
    - **Recognition of PP&E**
    - **Measurement at and Subsequent to Acquisition**
  - **Auditor Issues**
    - **Key Learning Points**
    - **Depreciation**
    - **Impairment**
    - **Subsequent Expenditure**
  - **Disclosure and Reporting**

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Participant’s Guide for CBT - 3 and ILT - 3 (Accounting for Property, Plant & Equipment)
As a result of completing this course, the participant will be able to achieve the following objectives in each of the respective units of the course:

- Identify examples of PP&E in the context of UN system organizations
- State the principal differences between the current UNSAS (United Nations System Accounting Standards) and IPSAS in accounting and reporting for PP&E
- Discuss the benefits and challenges of IPSAS 17
- Summarize how PP&E items can be grouped into classes
- Identify the criteria for recognition of PP&E
- Explain how to measure PP&E at acquisition and subsequently
- State why and how PP&E is depreciated
- Discuss situations that cause impairment of PP&E and the related accounting
- Outline causes for de-recognition of PP&E and accounting implications
- Explain how to report PP&E in the Financial Statements
- Identify common audit issues in the area of PP&E

2. Course Introduction

   a. Understand what PP&E is and give specific examples in the UN System context.
   b. Explain the difference between PP&E and inventories.
   c. Acquire basic understanding of the business process and key definitions related to PP&E: from acquisition through disposal.

3. Changes, Benefits and Challenges

   a. List the principal differences between UNSAS and IPSAS in the treatment of Property, Plant and Equipment.
   b. Explain the main benefits deriving from the use of IPSAS 17.
   c. Recognize what IPSAS 17 Property, Plant and Equipment does not provide.
   d. Identify key activities/challenges that UN system personnel will undertake to implement IPSAS 17.
   e. Explain the options available to measure PP&E at first time of IPSAS adoption and the impact in the Financial Statements.
   f. Identify key challenges subsequent to initial adoption.
   g. Explain the reason for applying transitional provisions and the maximum length in case of IPSAS 17.
4. Classification of Property, Plant and Equipment

   a. Define what is meant by a class of property, plant and equipment.
   b. Describe the 6 recommended classes of property plant and equipment for the United Nations System.
   c. Identify when additional classes of property, plant and equipment are appropriate to account for and disclose.
   d. Demonstrate how an asset rolls up into an asset class.
   e. Define what is meant by a heritage asset and the UN System policy on recognition of heritage assets.

5. Recognition of Property, Plant and Equipment

   a. Understand what is meant by capitalisation threshold and state the UN system recommended accounting practice for PP&E threshold.
   b. Understand what is meant by “group assets” and capitalization.
   c. Identify the conditions for recognition of an asset.
   d. Recognize situations where an entity might have control over an asset but no legal ownership.

6. Measurement at and Subsequent to Acquisition

   a. Identify 4 common ways that an item of PP&E can be acquired in the UN System and how the measurement differs in each case.
   b. Explain the difference between using a “cost model” and a “revaluation model” for measuring property, plant and equipment, including the implications of each model.
   c. State the UN System Recommended Accounting Policy regarding subsequent measurement of property, plant and equipment.
   d. Indicate what kind of subsequent expenditure qualifies for capitalization.

7. Depreciation

   a. Explain why PP&E are depreciated.
   b. Discuss the relationship between the cost of PP&E, the residual value, the depreciable amount, and the periodic depreciation charged.
   c. Explain when depreciation starts and when it ceases and give examples of assets that are not subject to depreciation.
   d. Identify factors that should be considered in determining the useful life on an asset.
   e. Describe the major depreciation methods.
   f. Explain how the depreciation of different components of an item of PP&E best reflects economic reality.
   g. State the UN system-wide recommended accounting practices related to depreciation.
8. Impairment of Property, Plant and Equipment

a. Explain the concept of impairment of PP&E.
b. Give examples of situations that lead to impairment losses according to IPSAS 21 - Impairment of Non-Cash-Generating Assets.
c. Describe how impairment losses are calculated.
d. Identify possible alternatives when an asset of PP&E is impaired and the respective accounting treatment.


a. Give examples of situations in the UN system context that lead to derecognition.
b. Explain how gains or losses realized upon de-recognition of property, plant and equipment are calculated.
c. Identify practical implications related to derecognition of property, plant and equipment.

10. Disclosure and Reporting of Property, Plant and Equipment

a. Describe how property, plant and equipment is shown in the financial statements.
b. Apply the formula to reconcile carrying amounts of property, plant and equipment between the beginning and the end of the financial statement reporting period.
c. Identify disclosures required to be presented for each class of property, plant and equipment.
d. Recognize what must be disclosed concerning property, plant, and equipment that is not recognized due to use of transitional provisions.

11. Common Audit Issues

a. Identify common audit issues related to property, plant and equipment.

12. Key Learning Points

a. Summarize key learning points.
Unit 2: Introduction

Every UN system organization uses tangible physical assets to carry out its mandate, achieve its goals and implement its objectives. Depending on the specific mandate under which an organization operates, these physical assets can include: land, buildings, vehicles, furniture and fixtures, communication and IT equipment, leasehold improvements and other assets.

This Unit provides examples of items of Property, Plant and Equipment (PP&E) in the UN system context; it explains the differences between PP&E and Inventories and discusses key concepts related to the accounting for PP&E at different stages of its business cycle.

By the end of this unit you will be able to:

- Understand what PP&E is and give specific examples in the UN System context.
- Explain the difference between PP&E and inventories.
- Acquire a basic understanding of the business process and key definitions related to PP&E: from acquisition through disposal.
2.1 Property, Plant and Equipment Defined

Every United Nations organization uses tangible physical assets to carry out its mandate, achieve its goals and implement its objectives. Property, Plant and Equipment (PP&E) refers to physical assets which are controlled and used by an organization for more than one reporting period.

There are a number of issues that accountants and management must resolve when considering how particular items should be accounted for and reported in the financial statements. Some of these are the following:

Is this item an asset? What is the item’s value? How long will it be useful to us? Will it have any value after we are finished using it? How should we account for the reduction in its usefulness through time? How should we show all this in our financial statements?

This course will provide you with key concepts that will enable you to answer these questions.

Many organisational assets are long-lived – that is to say that they provide economic benefit or service potential over a period of years of an organisation’s operations. These long-lived assets include:

1) property, plant and equipment and
2) intangible assets

This course addresses the first category of long-lived assets – property, plant and equipment.

IPSAS 17 defines property, plant and equipment as tangible items that are:

a. held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
b. expected to be used during more than one reporting period.

Now that you know how to define property, plant and equipment, let’s look at some types of property, plant and equipment typically held by UN System organisations.
2.2 PP&E vs. Inventory

Tangible items that are held for sale, distribution, or consumption in the normal course of operations are *inventories*. Inventories are normally used up during a current operational period, or within a year from their acquisition. Inventories are addressed in depth in another course in this series of courses.

_Eg- Icon_ Most spare parts are carried for as inventory however, however major spare parts may qualify as PP&E when the entity expects to use them over more than one period.

Vehicles are generally considered PP&E, however vehicles being held by an agency before being distributed for humanitarian purposes are considered inventories.

**Note**

Sometimes the only way to differentiate between PP&E and Inventories is to know:

- the *reason* why the entity is holding the item
- how the entity uses the item
2.3 The PP&E “Business Cycle”

The PP&E “Business Cycle” is a sequence of activities in the United Nations organization which takes PP&E from acquisition through disposal/write-off. The process of using and accounting for assets – and property, plant, and equipment in particular – can be divided into a set of coordinated tasks and activities. One way you can organize these tasks and activities is to apply the following framework:

**PP&E Key Definitions – Illustrative Business Cycle**

- **Direct costs** - Acquisition price, freight, insurance, assembly and installation costs - need to be “**Capitalized**” as part of the cost.

- **Initial Recognition** – An item of PP&E is recognized when the entity gains “**Control**” over it.

- **“Depreciation”** - In order to reflect the usage of an item and the reduction of its value with time, depreciation is recorded during its “**useful life**”. Recording of depreciation starts as soon as the item is available for use.

- **“Impairment”** - Some unexpected events can happen that cause a reduction in an items’ value (beyond normal depreciation) such as accidents or obsolescence. In such cases, impairment is recorded.

- **“Subsequent expenditure”** - During an items’ useful life repairs and maintenance are “expensed”, whereas “**major upgrades**” (that increase the economic benefit or service potential - i.e. useful life or output) are “capitalized”.

The flowchart above helps to illustrate key definitions within the PP&E business cycle. We will be looking at each of these concepts in detail throughout this course.
6) “Derecognition” - When an item of PP&E is no longer needed, or has been stolen, sold or donated (retired from active use) it is removed from the “financial statements”.

Note

All the above events should be recorded in the “Asset Register” and reflected in the “Financial Statements” to ensure completeness and accuracy.
One of the major differences between the current United Nations System Accounting Standards (UNSAS) and IPSAS is accounting and reporting for PP&E. Even though PP&E is currently known in UNSAS as “Non-expendable Property”, this denomination does not match the accounting treatment under UNSAS (which does not follow full accrual accounting) does not match IPSAS, as PP&E is indeed (in most cases) expensed when the Purchase Order is issued.

For many UN System Organizations, PP&E is also one of the areas where the major implementations challenges are expected both at initial adoption and in subsequent to that periods. On the other hand, substantial benefits are expected from the improved accounting and reporting of PP&E that should translate into better decision making and enhanced oversight. The role of non-finance staff with responsibility for asset management will be even more critical as information maintained in the asset register will directly impact the figures reported on the face of the financial statements.

By the end of this unit you will be able to:

- List the principal differences between United Nations System Accounting Standards (UNSAS) and IPSAS in the treatment of PP&E.
- Explain the main benefits deriving from the implementation of IPSAS 17.
- Recognize what IPSAS 17 PP&E does not cover.
- Identify key activities/challenges that UN system personnel will undertake to implement IPSAS 17.
- Explain the options available to measure PP&E at first time of IPSAS adoption and the impact in the Financial Statements.
- Identify key challenges subsequent to initial adoption.
- Explain the reason for applying transitional provisions and the maximum length in case of IPSAS 17.
3.1 Differences between UNSAS and IPSAS
Previous courses in this series have contrasted UNSAS with IPSAS in general. It is useful to note some specific differences between UNSAS and IPSAS in regard to property, plant and equipment. The following illustration lists the principle differences between UNSAS and IPSAS.

**Principal Differences between UNSAS and IPSAS**

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<th>IPSAS</th>
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<tr>
<td>▪ PP&amp;E is not capitalized and not subject to depreciation (PP&amp;E expensed when purchase order “PO” is issued);</td>
<td>▪ PP&amp;E is capitalized and depreciated over useful live (commitments for acquisition of PP&amp;E (POs) disclosed in the Notes);</td>
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<tr>
<td>▪ Entities disclose the total value of PP&amp;E at original acquisition cost in the Notes;</td>
<td>▪ Reconciliation of beginning balance and ending balance of PP&amp;E is required in the Notes (including additions, disposals, depreciation and impairment);</td>
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<td>▪ Most “self constructed assets” are not tracked;</td>
<td>▪ Costs related to “Self constructed assets” should be tracked and capitalized if asset recognition criteria is met;</td>
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<td>▪ Major overhauls (substantial improvements) to assets are expensed as incurred;</td>
<td>▪ Major overhauls (substantial improvements) to assets are capitalized;</td>
</tr>
<tr>
<td>▪ Impairment losses are not recognized when they occur (since PP&amp;E items are expensed on purchase)</td>
<td>▪ Impairment losses are recognized in the period they occur;</td>
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3.2 Benefit of Adopting IPSAS
The greatest benefit of adopting IPSAS is gaining an accrual accounting framework for recording and reporting information that is useful to management and for users of UN System organization general purpose financial statements. In particular, IPSAS 17 treatment of property, plant and equipment provides better information to support better financial management. The adoption of IPSAS 17 provisions provides the following benefits:

- Identification of the economic value of the asset owned by an organization – supporting better capital planning.
- Reporting expenses as the value of inputs used in provision of core services (rather than in the period in which they were paid).
- Identification of the mix of resources (long-term/current) used by an organization in providing its core services.
- Creation of higher quality and more credible UN System financial reports.
- Facilitation of comparability with other international organizations and national governments.
In order to obtain these benefits, substantial changes must be made in the way United Nations organizations process and use their information. The following chart and accompanying legend explain the relationships between IPSAS requirements, changes United Nations organizations must make, and the resulting opportunity for improved management and stakeholder decision-making.

Financial Statements – IPSAS 17 requires:
- Items of PP&E to be reported as assets.
- Items of PP&E to be expensed as depreciated throughout useful life (not on acquisition).
- Detailed disclosures of types and values of PP&E and reconciliation of beginning and ending balance.

Data analysis, conversion & maintenance

Initially:
- Detailed survey of existing types of PP&E items
- What are they?
- Where are they?
- Do we control them?
- How much are they worth?

Subsequently:
- Maintenance of reliable PP&E data:
  - Formal PPE control procedures and physical verifications.
  - Capitalize freight and other acquisition costs.
  - Tests of impairment and periodic reviews of useful lives.
  - Capture and capitalize major overhauls.
  - Classify each acquisition by asset class.
Upgrade of Systems and Controls
- Upgrade or acquire asset register to track, value, account, report PP&E assets and support their management.
- Improve mechanisms of internal control, workflows and business processes.
- Create or upgrade PP&E manual and management guidelines.

Better decision making:
- Better information about nature and condition of assets strengthens capital planning and asset management
- Identifies mix of resources (long-term/current) used by an organization in providing its core services
- Enhances oversight of PP&E which can expedite service delivery and improve efficiency in fulfilling the mandate
- Increases transparency in reports allowing donors to better evaluate programs - as PPE is expensed as used and not when purchased – the rate of implementation of a project is a better reflection of the “true cost” of service delivery for the reporting period

Benefits of IPSAS 17

3.3 Challenges of adopting IPSAS 17

There are many challenges to UN system organizations regarding first-time adoption of IPSAS 17. The following diagram indicates many of the challenges UN system
organizations face and describes what those challenges entail. The degree of challenge will depend on a variety of factors including:

**Audit observations** – The extent to which an organization has received audit observations and recommendations in the area of PP&E and has implemented (or not) those recommendations could give an indication about the level of challenge.

**Internal control and tracking systems** – If internal controls are not robust and tracking systems (such as bar-coding) are not in place (or in place but not reliable), the level of challenge will be higher.

**Complexity of business process** – Some organizations have more complex business processes related to PP&E, such as frequent subsequent upgrades, frequent impairments, situations where control is not clear (for example shared assets), etc.

**Changes required in information systems** – Some organizations will have to replace their fixed assets module, whereas for others an upgrade of the current system will be sufficient to comply with IPSAS requirements.

**Existence of a variety of different types of PP&E** – Depending on the mandate of the organization, the variety of types of PP&E can become more challenging – for example, existence of self-constructed assets.

**Geographical dispersion and quality of data** – The extent to which organizations have to collect information for opening balances from a variety of geographical locations will increase the level of challenge, especially if current fixed asset registers cannot provide reliable data for opening balances.

**Overall materiality of PP&E** – Organizations in which much of the PP&E has reached the end of its useful life (and thus the carrying amount of those items of PP&E is zero) will have fewer challenges obtaining beginning balances than organizations with significant carrying amounts of PP&E.

### 3.4 Scope of IPSAS 17 and challenges UN System organizations face

IPSAS is principles based. It deals with concepts, definitions and accounting principles. IPSAS set out the requirements for financial reporting by governments and other public sector organizations. IPSAS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events in general purpose financial statements. IPSAS are a standards-based approach to financial accounting and reporting. As such, they do not prescribe specific steps to the recording and adjustment of accounting information.

At a UN System-wide level, harmonized accounting policies and guidance on IPSAS 17 have been approved and are included in this training course at a summarized level, but are supported by detailed policy and guidance papers. These harmonized policies and guidance support consistency in accounting and reporting among UN System
The following paragraphs describe some of the practical challenges many UN system organizations will encounter in implementation of IPSAS – first at initial adoption of IPSAS, and then in subsequent years. IPSAS 17 does not provide specific guidance in these areas.

Challenges at initial adoption:
- Obtaining beginning balances
- Decisions on accounting and reporting policies
- Processes and workflow re-engineering
- Information systems evaluation
- Training and communications

Obtaining beginning balances
A detailed survey of existing items of PP&E will need to be conducted. For most organizations in the UN System existing data in current asset registers is not complete, since it likely excludes the following types of assets: shared assets, assets controlled but not owned (such as finance leases and right to use buildings), “self-constructed” assets including buildings and infrastructures, such as roads.

In cases of “complex asset” such as buildings, major components will have to be identified and assigned useful lives.

Once a detailed survey of PP&E items has been performed, the items will have to be valued. This might involve the recording of pending impairments and requesting the
service of professional appraisers. Some organizations might be able to obtain data from their current asset register. In this case they will first have to determine whether the existing data in the current systems is “reliable” (complete and accurate) from an IPSAS perspective, i.e. whether the data complies with the requirements of IPSAS 17.

**Decisions on accounting and reporting policies**

There are many accounting and reporting policies that UN System organizations will need to revise or develop to gain compliance with IPSAS requirements. Some of these include the following areas:

- Determining capitalization threshold (up to $5,000) and policies on asset groupings
- Setting policies on expensing or capitalising subsequent expenditure
- Developing impairment policies
- Identifying useful lives within approved ranges for all types of PP&E
- Deciding useful lives of asset components (e.g. plumbing and heating system of a building)
- Identifying situations of control over shared assets
- Determining if further classes are needed for disclosure and respective lives
- Deciding how to measure beginning balances (cost or fair value)
Processes and workflow re-engineering

UN System organizations will need to develop systems to:
- track goods in transit, passage of legal title, contractual provisions (e.g. “Incoterms 2000”), transfers and disposals (for details on INCOTERMS, see International Chamber of Commerce website at http://www.iccwbo.org/incoterms/id3040/dex.html);
- allocate costs (e.g. initial freight of purchased items, direct materials and labour of self-constructed PP&E);
- identify sources of fair value data for PP&E (e.g. for donated PP&E);
- verify both the quantitative (how many) and qualitative (impairment, losses, etc) aspects of PP&E;
- identify, distinguish and value major overhauls vs. normal ongoing maintenance.

IPSAS requires periodic reviews of items of PP&E in order to test for impairment. While some organizations might already be performing similar reviews, compliance with IPSAS is likely to require much more detailed and accurate tests for impairment.

The chart below illustrates the changes that will have to take place in terms of workflow re-engineering.
**Information systems evaluation**
Organizations must ensure that decisions on accounting and reporting policies are supported by adequate information systems (for example, updated chart of accounts and posting rules, cost allocation policies, threshold for capitalization and grouping of assets, useful lives, etc.) Current information systems may need to be upgraded, reconfigured or replaced.

**Training and communications**
Organizations must ensure the following activities are programmed to support adoption of IPSAS:

- successful roll-out of IPSAS training and awareness;
- involvement of field offices and HQ in surveying of existing PP&E;
- co-ordination of work between different departments;
- communication of any changes in workflows;
- training of target groups (e.g. finance and asset management); and
- testing of new IT functionalities;

**Valuation of PP&E at initial adoption of IPSAS**
At initial adoption of IPSAS, UN System organizations will have the option to value PP&E at either cost or fair value as at the date of initial recognition. Organizations must make the choice a class-wide basis. For example, an organization can value all its buildings and land at fair value, and all its IT and communications equipment at cost. Within each class, all sub-categories (or sub-classes) must be valued using the same method.

UN Guidance Paper 44 provides a process that UN System organizations can use when adopting IPSAS for the first time and recognising existing PP&E. The following diagram illustrates the process used to record the opening values of pre-existing property, plant and equipment.
The effect of initial recognition of PP&E is to record (debit) the asset values recognized and to record (credit) an equal value directly to the opening balance of accumulated surpluses or deficits (equity), and to disclose these amounts and new balances in the financial statements and in the Notes to the Financial Statements for the period in which the property, plant and equipment is initially recognized.

IPSAS 17 allows a “Transitional Provision” of 5 years, which means that entities have 5 years subsequent to date of issuance of the first IPSAS-compliant Financial Statements to recognize all PP&E. When an entity uses transitional provisions, it must disclose the extent to which the entity has applied any transitional provisions in the summary of significant accounting policies in the notes to the financial statements. PP&E that would already be fully depreciated when an organization first adopts IPSAS will not impact the amounts reported in the organizations’ financial statements. Initially it makes sense for organizations to treat these immaterial items as a low priority for data entry.

The UN Recommended Accounting policy is to “…use transition periods only to the extent necessary to ease the difficulty of compliance with a particular IPSAS…”

When entities adopt accrual accounting in accordance with IPSAS for the first time, they often have difficulty in compiling comprehensive information on the existence and valuation of assets. Accounting for and reporting on property, plant and equipment is one of the more difficult and time-consuming accrual accounting activities, but it also has the potential for allowing great gains in organizational effectiveness, economy, and efficiency. Furthermore, it is often an area of great interest to key stakeholders.

Challenges subsequent to initial adoption – primarily maintenance and record keeping:

- Ensuring reliable data in the asset register (completeness of PP&E data and valuation in accordance with IPSAS);
- Conducting regular tests of impairment and reviews of useful lives;
- Ensuring robust systems of internal control and oversight of PP&E are in place;
- Following up on any audit findings and observations

Ensuring reliable data
Appropriate classification of, and accounting for, PP&E requires the planning, participation, and interaction of the financial, procurement, logistical, asset/inventory management and IT departments in each UN System Organization.

Conducting regular tests of impairment
Impairment, which reduces PP&E value and/or useful life, will be discussed in Unit 8.

Ensuring robust systems of internal control and oversight
Internal control is a process instituted by an organization’s governing body, management and other personnel. Internal controls are designed to provide reasonable assurance regarding the achievement of objectives in three categories:
1) effectiveness and efficiency of operations;
2) reliability of financial reporting; and
3) compliance with applicable laws and regulations.

Internal control are considered effective in each of these categories if the governing body or management have reasonable assurance that:

1) they understand the extent to which the entity’s operations objectives are being achieved;
2) published financial statements are being prepared reliably; and
3) applicable laws and regulations are being complied with.

**Following up on any audit findings and observations**

Management must act on audit findings and auditor observations in order to ensure their organization is appropriately following IPSAS requirements. Common Audit Issues are discussed in Unit 11.
Unit 4:
Classification of PP&E

In Unit 2, we saw some examples of PP&E items which are common in the context of UN system organizations. In this Unit, we will show how individual items should be grouped into classes for purposes of disclosure in the Notes to the Financial Statements.

By the end of this unit you will be able to:

- Define what is meant by a class of PP&E.
- Describe the 6 recommended classes of PP&E for the UN System.
- Identify when additional classes of PP&E are appropriate to account for and disclose.
- Demonstrate how an asset rolls up into an asset class.
- Define what is meant by a heritage asset and the UN System policy on recognition of heritage assets.
4.1 Asset Classes

A class of property, plant and equipment is a grouping of assets of a similar nature or function in an entity’s operations that is shown as a single line-item for the purpose of reporting value and providing disclosure in the financial statements.

The reason to have uniform classes of property, plant and equipment across all UN System organizations is improve comparability of their financial statements. As you learned previously, the financial statements provide a summary of accounting information. The level of detail of assets presented on the face of the Statement of Financial Position may, in most cases, be much higher than by asset class. That is to say, that statement may present a single line item of “Property, Plant and Equipment”. However, the Notes to the Financial Statements would contain considerably more detail on the composition of the organization’s property, plant and equipment.

**UN System Decision**

UN System organizations should disclose PP&E in the following 6 classes in the Notes to the Financial Statements:

- Communication and IT Equipment
- Vehicles
- Furniture and Fixtures
- Leasehold Improvements
- Buildings
- Land

**Communication and IT Equipment** generally includes: equipment used in automatic data processing, computing, and telephone communications. This includes central processing units, mass storage, routers, terminals, mainframes, desktops, laptops, satellites, etc.

**Vehicles** generally includes: light- and heavy-duty vehicles, including autos, pickups, trucks, tractors, busses, motorcycles, aircraft, boats, etc.

**Furniture and Fixtures** generally includes: desks, cabinets, tables, chairs, office dividers, etc.

**Leasehold Improvements** generally include: additions and alterations performed by the lessee (the “user” not the “owner” of the leased property). In order to qualify for capitalization the improvements must be affixed to the property and increase the service potential/future economic benefit of the asset. Examples include:
- Significant upgrades to electrical and wiring system
- Installation / construction of permanent fixtures (walls, doors, windows, roof replacement, land improvements…)
- Major upgrades to security system

Recurring costs, involving small expenditures that neither add materially to the use service potential or future economic benefit of the asset should be expensed as incurred:

**Learn More**

There is a separate course on Leases that addresses the issue of leasehold improvements in more detail.

---

**Buildings** generally includes: office buildings, residences, garages, warehouses, storage buildings, temporary shelters (including prefabricated facilities), etc.

---

**Land** generally includes all types of land and the direct costs of acquiring it and putting it to intended use.

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**Implementation Issue**

UN System Organizations will have to survey their PP&E in order to determine if other significant material groups of assets exist and if that is the case additional classes of PP&E should be disclosed.
Possible additional classes include:

- Construction in Progress
- Safety and Security
- Medical Equipment
- Machinery
- Infrastructure Assets
- Land Improvements

Infrastructure Assets usually display some or all of the following characteristics:

a) They are part of a system or network;
b) They are specialized in nature and do not have alternative uses;
c) They are immovable; and
d) They may be subject to constraints on disposal

Some examples of infrastructure assets are bridges, roadways, communications lines, port facilities, utilities plants, and airports.

Land improvements will be briefly addressed later in this course.

Some aspects of determining whether a group of assets is significant (material) enough for disclosure in a class of its own, separate from other groups of assets, are whether:

1) The amount of value of that group of assets is relatively large;
2) The use of that group of assets is essential or very important to the operations of the organization;
3) The use of that group of assets is a sensitive area for the organization, and its stakeholders.

What is significant, or “material”, in public sector organizations can be quite different than that in private sector companies. This is because the financial statements of a public sector organization may be relied upon in making significant public policy decisions that have far-reaching political, social, and security implications. Public sector financial statements disclose much more information than merely the results of economic decisions made by the organization – they provide information needed to determine the discharge of the organization’s responsibilities for stewardship, accountability, efficiency and effectiveness.

Public sector organizations must strive to avoid misunderstandings arising from not providing sufficient information to key stakeholders. Often, public sector organizations must be concerned about the nature of transactions and the level of detail in their disclosure, rather than only the financial materiality of transactions and balances that could be construed as wasteful, fraudulent, corrupt, or evidencing related party transactions. This means that the “qualitative significance” of information about the organization is important. “Qualitative significance”, as used in this course, refers to the nature of transactions concerning assets that, independent of its amount, may influence the decisions of a user of the financial statements.

Can you think of other classes of property, plant and equipment in the context of your organization?

**Note**

Because additional disclosures are required for each class of PP&E, it is recommended that organizations aim to have no more than ten separate classes. The approved recommended practice identifies six classes, notes that further classes should be added if material, while also noting the possibility of amalgamating classes if some are immaterial or creating another class called “Other” which would include all remaining types of PPE that do not fit into the other classes. The end result in terms of number of classes should remain around six. This flexibility guides organizations across the United Nations system towards harmonized disclosures on PP&E classes, while acknowledging that different organizations may have markedly different types of PP&E.

Organizations should also bear in mind that decisions on classes of PPE also impact policies for valuation - at initial adoption of IPSAS beginning balances can be valued at cost or fair value and this decision is applied on a class by class basis.
The photo below illustrates 3 classes of PP&E in a typical UN field environment.

This diagram illustrates how assets roll up into asset classes, through several levels of sub-classes. It illustrates possible sub-classes within the class of Communications and IT equipment.

### Classes of UN Property, Plant and Equipment

![Diagram of classes of PP&E](image-url)

- **Property, Plant and Equipment**
  - **Vehicles**
  - **Communication and IT Equipment**
  - **Furniture and Fixtures**
  - **Leasehold Improvements**
  - **Buildings**
  - **Land**
  - **Office and Computer Machinery**
  - **Surveillance/Control Equipment**
  - **Telecommunication Equipment**
  - **Category n**
4.2 Heritage Assets
Heritage Assets have cultural, environmental or historical significance. They include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art.

Many UN System Organizations have heritage assets, like paintings, sculptures and other works of art. Even though they are not to be considered PP&E, adequate measures to safeguard these assets should be in place.

**UN System Decision**
The UN Policy is to not recognize Heritage Assets
Unit 5: Recognition of Property, Plant, and Equipment

In order to recognize assets as Property, Plant and Equipment, specific criteria should be met, for example the item should either have an amount that is higher than or equal to the established “threshold” of recognition or it should fall under the category of “group asset”. Lower value items can still be tracked for purposes of internal control and stewardship of resources but do not need to be capitalized.

The recognition of Property, Plant and Equipment is also directly related to the issue of “control”, in some situations it is not easy to determine who has control over a specific asset. This unit explains when to capitalize an item of PP&E and identifies situations where an entity might have control over an asset but no legal ownership.

By the end of this unit you will be able to:

- Understand what is meant by capitalization threshold and state the UN system recommended accounting practice for PP&E threshold;
- Understand what is meant by “group assets” and capitalization;
- Identify the conditions for recognition of an asset; and
- Recognize situations where an entity might have control over an asset but no legal ownership.
5.1 Recognition Thresholds

The UN Recommended Accounting Practice is to recognize (capitalize) as property, plant and equipment all assets which have a value greater than US $5,000 equivalent at the date of their placement into service.

UN System Decision

UN Recommended Accounting Practice – at a UN system-wide level a maximum threshold for recognition of PP&E of $5,000 was approved. This means that each organization should recognize (capitalize) as property, plant and equipment all assets which have a value equal to or greater than US $5,000 equivalent at the date of their placement into service.

However, each UN System Organization may set a lower threshold for capitalization if more relevant to them. For example:

- Org. A: >2,000 USD equivalent
- Org. B: >3,000 USD equivalent
- Org. C: >4,500 USD equivalent

Lower Value Assets and Group Assets

The value of many assets acquired may not reach the threshold set by the UN System organization for capitalization – for example a single printer. The cost of such “small assets” is expensed in the period in which they are put into service. They are not recognized for financial statement purposes as property, plant and equipment.
Although they are not recognized as property, plant and equipment, UN System organizations should still take appropriate actions to maintain control over non-capitalized small assets. Typical measures to safeguard such “small assets” include:

- restriction of access by non-authorized personnel,
- periodic examination/counting,
- recording of asset serial numbers,
- bar-coding for easy identification/verification in asset audits, and
- other custodial measures.

UN System organizations can capitalize some “small assets” as property, plant and equipment, notably when they are:

1) acquired together as a group;
2) similar in nature and use; and
3) clearly not inventories

Several examples of this common to UN System organizations are: furniture, computer peripherals, library books, prefabricated kitchen units, hard wall modular structures, and accommodation units. Some sets of tools, while individually inexpensive, but collectively of significant value, and which are expected to last several years, could also be subject to capitalization. Such capitalized groups of small assets are recognized for financial statement purposes as PP&E.

We emphasize that items falling below the capitalization threshold can still be tracked, hence there is no reason for increased risk of theft. In fact, independent of the
capitalization threshold established, lower value items can still be tracked if management decides to do so.

5.2 Conditions for Recognizing PP&E

There are general conditions which must all be met for an item to be recognized as an asset. Property, plant and equipment can be recognized (recorded as a capital asset), if and only if all conditions are met. The following chart illustrates these conditions.

**Asset and control Checklist**

**Asset Checklist**

- Control Checklist: Use/Benefit
  - Exclude/Regulate Access
  - Bears Risk
- Results from a Past Event
- Cost or Fair Value is a reliable Measurement of its Value

As you can see, control of an asset is an extremely important concept in determining whether it can be recognized or not. But, in fact, all conditions must be met to recognise an asset, and therefore to capitalize an item of property, plant and equipment.

A question that UN System organizations frequently ask is:

“Are property, plant, and equipment, which are purchased as part of a project, with funds provided by a donor, assets of the UN System organizations that implement the project?”
In most situations a UN System organization purchases and has legal title over the project assets. It has use and custody of the purchased items, even if those assets must be given to other parties, for example the country receiving aid, at the end of the project.

The key to deciding how to account for such items of property, plant and equipment is determination of who controls those assets.

Control over an asset arises when an entity can:

- use or otherwise benefit from the asset in pursuit of its objectives;
- exclude or otherwise regulate the access of others to that benefit

It may not matter who has legal title to an asset. It does matter who controls it!

But, for an organization to recognize an item of property, plant and equipment, or any other asset, the five conditions for recognition of an asset must be met.

You will learn more on the topic of “control” later in this course.

It is well worth repeating here, that an asset can be capitalized – recognised as property, plant and equipment - when it is held for use in the production of goods or services, for rental to others, or for administrative purposes, and when it is expected to be used during more than one reporting period.

It is also worth stating the definition of capitalization - the recognition of a non-current asset whose costs are systematically charged over the same period in which benefits from that item are to be received.

This is a good place to consider another aspect of determining when an asset is inventory and when it is property, plant and equipment. Often the determination of whether to capitalise an asset and record it as property, plant and equipment, or to record it as inventory, depends on how the particular UN System organization uses that asset. Two good examples are:

1) books, and
2) vehicles
Books
Let’s consider a set of books. The life of this set of books begins with it being produced by a UN System organization.

Perhaps we can consider, with some simplifying assumptions, the WHO Press’s Blue Trunk Library (“BTL”) – a collection of more than 100 books on medicine and public health, packed into a durable blue metal trunk for transport, storage, and display. The WHO Press produces 65% of the BTL using the following: publication rights (intangible assets), paper, cardboard, ink (raw materials), blue trunks (inventories), computers, printers, binding machines (property, plant and equipment), and employees (labour). These sets of books (valued at their accumulated costs to produce) become inventory of the WHO Press.

The WHO Press takes orders for BTLs from a country until there are at least 20 sets ordered. Each BTL sells for 2,000 USD, including in-country training of those persons responsible for them at the district level, plus actual cost of shipping. When it sells, transfers, or donates the BTLs, it derecognises inventory and expenses its costs, and recognizes any revenues it collects for the sale of that inventory.

The World Bank, the European Union, UNDP and UNICEF have provided funding for the project in various countries. Other bilateral cooperation and aid agencies have chosen to include the Blue Trunk libraries in their own health centre projects in countries. It should be mentioned that a significant number of Blue Trunk libraries have been funded by the Offices of WHO Representatives. The organization that receives the BTLs would consider them as property, plant and equipment because they are tangible goods and are:

- held for use in the supply of services, or for administrative purposes; and
- expected to be used during more than one reporting period.

If a UN System organization mission used a BTL in its operations, it could be property, plant and equipment for that organization (subject to the organization’s capitalisation threshold.)
Vehicles
Now let’s consider a group of vehicles purchased and distributed by the United Nations Logistics Base (“UNLB”) in Brindisi, Italy.

To support the UN Peacekeeping Missions, the UN operations worldwide, and the activities of UNLB, the Procurement Section conducts all purchasing actions for and on behalf of UNLB. The Procurement Section is the sole entity within UNLB authorized to:

- Solicit bids on behalf of UNLB;
- Enter into negotiations with vendors;
- Issue official purchase orders for goods or services.

For the sake of this example, assume the UNLB negotiated the purchase of a lot of 100 Nissan Patrol vehicles meeting a standard specified by the UN Department for Peacekeeping Operations (UNDPKO), for use in peacekeeping activities in Africa and the Middle East. For the UNLB, these 10 vehicles would be inventory.

Assume that 10 of these vehicles are for use in the MONUC operation in the Democratic Republic of Congo. The UNLB would ship these vehicles to the MONUC operation. Upon receipt and control over these vehicles, these same vehicles would be property, plant and equipment for the MONUC operation because they are tangible goods and are:

a. held for use in the supply of services, or for administrative purposes; and
b. expected to be used during more than one reporting period.
Learning Check Points
Group Exercise
Unit 6: Measurement at and Subsequent to Acquisition

The measurement of cost of an item of property, plant and equipment at acquisition will depend on the way the item is acquired. In the context of the UN System organizations it is common to obtain items of PP&E by a variety of ways, such as: purchase, donation, self-construction or lease.

This unit explains how to value an item of PP&E both at acquisition and subsequently. It also introduces the two models “cost” vs. “revaluation” and discusses the treatment of subsequent disbursements related to PP&E.

By the end of this unit you will be able to:

- Identify four common ways that an item of PP&E can be acquired in the UN system and how the measurement differs in each of the following cases:
  - Purchase
  - Donation
  - Self construction (including leasehold improvements)
  - Capital lease
- Explain the difference between using a “cost model” and a “revaluation model” for measuring PP&E, including implications of each model
- State the UN System Recommended Accounting Policy regarding subsequent measurement of PP&E; and
- Explain the types of subsequent expenditure that qualify for capitalization.
6.1 Common Ways to Acquire PP&E

In the UN System context there are different methods by which PP&E can be acquired, such as:

- Purchase
- Self-construction
- Donation
- Capital lease

The most common way to acquire PP&E is through purchase from an external party, such as a vendor.

“Self-construction” of PP&E refers mainly to buildings and upgrades of office space. It does not always mean that the organization’s staff is performing the construction – in most cases it is subcontracted. However, sometimes, especially in field offices, staff may “self-construct” items such as infrastructure or temporary shelters.

In some cases, UN System organizations obtain donations of PP&E, usually from governments.

Finance leases qualify for capitalization.

Also major improvements to items of PP&E under operating leases qualify for capitalization and are shown in a separate class of PP&E and are called “Leasehold Improvements”.

6.2 Measurement of PP&E at Acquisition

Items of PP&E are measured at “cost” when first acquired and reported (i.e. recognized). Depending on the method of acquisition, different elements are considered in order to determine the cost at initial recognition.

**Purchased PP&E**

The cost of an item of PP&E purchased comprises:

- **a.** Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- **b.** 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.
- **c.** The initial estimate of the costs of dismantling and removing 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.
The following slide summarizes the key points of costs included in capitalization of purchased PP&E.

Getting the asset to the location...
- The purchase price (including import duties and non-refundable taxes, after deducting discounts and rebates)
- Freight (transportation), insurance and all costs necessary to bring the asset to the location and condition in the manner intended by management
- Initial delivery and handling costs

...and condition required by management
- Installation and assembly costs
- Testing costs

...plus dismantling and removing the item
- Initial estimate of the costs of dismantling and removing the item and restoring the site where it is located are also included in the initial PP&E cost

Certain costs to acquire an item of land should be included in its capitalised costs upon initial recognition. Costs directly attributable to bringing the land to the condition necessary for it to be used as intended also should be capitalised. These costs include:

1) title, registration, and other legal fees,
2) survey costs,
3) fees to obtain appropriate zoning (permission for an intended use),
4) costs to grade and drain land to make it suitable for use,
5) costs of tearing down old structures (net of any salvage value that may be extracted from the likes of old bricks or steel, etc.)

Self-constructed PP&E
When an item of property, plant and equipment is self-constructed, its cost is comprised of the same elements as for purchased property, plant and equipment. Tracking attributable costs is the key to proper valuation of self-constructed assets.

The following slide summarizes the key points of costs included in capitalization of self-constructed PP&E.
Self-constructed PP&E

Costs which are not included in measuring the value of property, plant and equipment include:

a. costs of opening a new facility;

b. costs of introducing a new product or service;

c. costs of conducting business in a new location or with a new class of customers;

d. maintenance and scheduled servicing; and

e. administration and other general overhead costs.

Donated PP&E

The following slide summarizes the key points of costs included in capitalization of donated PP&E.
Cost of PP&E acquired through Donation

What does “cost” mean when an item is donated?

- Items of PP&E acquired through donation should be valued at fair value as at the date of acquisition.

Implementation Issue

Donated PP&E results in the recognition of income for the recipient organization in the amount of the fair value of PP&E received. The value provided by the donor does not always represent fair value, hence organizations need to obtain fair values by reference to quoted prices or from an appraisal.

Finance Leases

Some UN System Organizations decide to lease equipment and buildings instead of buying them. A few lease agreements will qualify for “capitalization” (the so-called finance leases). Other lease agreements do not qualify for capitalization (the so-called operating leases), but major improvements made to those leased items might qualify for capitalization.

Under “capital leases”, leased items of PP&E that qualify for capitalization are valued at:

- fair value or present value of lease payments (if lower than fair value) at lease inception;
- plus initial direct costs of the lease + costs to install and prepare for use; and
- any major improvements.

Under “operating leases”, major improvements to leased items (such as buildings) can qualify for capitalization - when the improvements are permanent in nature and revert back to the lessor at the end of the lease. A common example of this is when UN System organizations build new walls in leased office space. In such cases rules of capitalization of self-constructed PP&E apply. Leasehold improvements are recorded as separate category of PP&E.
6.3 Measurement of PP&E in Periods Subsequent to Acquisition

IPSAS 17 provides two different methods that may be used for valuation of property, plant and equipment in periods subsequent to its initial recordation. The first, more traditional model, is the “Cost Model”, which uses the original cost of the item adjusted for accumulated depreciation and impairment losses. The second, more recently used because of higher rates of inflation, is the “Revaluation Model”, which periodically re-values PP&E to match current price conditions for the same or similar items.

Capitalization of Subsequent Expenditure on PP&E

Subsequent to initial recognition of PP&E there are two types of expenditure that can be made on existing PP&E which are accounted for differently: that which qualifies for capitalization, and that which is expensed when incurred.
In many cases complex items of property, plant and equipment (such as buildings, vehicles and aircraft) require major maintenance over their useful lives in order to maintain, or to extend, their usefulness. Sometimes such major maintenance is referred to as “overhaul” or “rebuild”. Such major maintenance is “subsequent expenditure”. The cost of replacing major components (parts) of an item of property, plant and equipment is added to the carrying amount of that property, plant and equipment (capitalized). The carrying amount of any components (significant parts that have been capitalized separately) that are replaced is derecognized.

**Cost Model vs. Revaluation Model**

<table>
<thead>
<tr>
<th>Cost Model</th>
<th>Revaluation Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original cost</td>
<td>Fair value (at the date of evaluation)</td>
</tr>
<tr>
<td>Less</td>
<td></td>
</tr>
</tbody>
</table>

Accumulated depreciation and accumulated impairment losses (to reflect the reduction of PP&E’s future economic benefit or service potential due to wear, aging or other factors)

= Item’s carrying amount

Additionally, the cost of major inspections or tests of an item of property, plant and equipment (for example, an aircraft), regardless of whether parts of the item are replaced, is recognized in the carrying amount of that item. Any remaining carrying amount of the cost of a previous inspection (as distinct from physical parts) is derecognized.

The capitalization of such major maintenance is subject to the following recognition criteria:

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

The following slide illustrates criteria of when to capitalize and when to expense expenditure on PP&E subsequent to acquisition.
Capitalization of Subsequent Expenditure

Subsequent to initial recognition of PP&E, there are two categories of expenditure that can be made on existing PP&E which are accounted for differently:

**Costs that qualify for capitalization**

- Replacement of a major part of an item - for example, a new engine in a car
- Major repairs and refurbishments that will either increase the useful life of the item or its service potential - for example, installation of additional ballistic protection in an armored truck
- Costs of major inspections or testing - for example, of an aircraft

**Costs that are expensed when incurred**

- Day-to-day servicing (including costs of labour and consumables and costs of small parts)
- Scheduled repairs and maintenance
- Non-scheduled repairs to bring the item back to its original condition - for example, repairing a vehicle after an accident

---

**Implementation Issue**

UN System Organizations will have to be in place in order to value and track costs that qualify for capitalization, including labor and materials.
Unit 7: Depreciation of PP&E

The usage of an item of PP&E the passage of time, wear and tear, depletion and technological outdating all contribute to a reduction in the value of an item of PP&E throughout its useful life. Depreciation expense is recorded each year to reflect all these factors.

This Unit presents recommended accounting practices for UN system organizations on useful lives ranges by class of PP&E, residual value and depreciation method. The Unit also presents an illustrative example.

By the end of this unit you will be able to:

- Explain why PP&E are depreciated.
- Discuss the relationship between the cost of PP&E, the residual value, the depreciable amount, and the periodic depreciation charged.
- Explain when depreciation starts and when it ceases and give examples of assets that are not subject to depreciation.
- Identify factors that should be considered in determining the useful life on an asset.
- Describe the major depreciation methods.
- Explain how the depreciation of different components of an item of PP&E best reflects economic reality.
- State the UN system-wide recommended accounting practices related to depreciation.
7.1 Key Definitions
Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. All Items of PP&E, except land, have limited useful lives. Because of this limited useful life, the costs of these assets must be distributed as expenses over the years they benefit. Reasons that cause a reduction in the value of an asset during its life include:

- Usage
- Wear and tear or physical deterioration
- Technological outdating or obsolescence

Land is not depreciated – it is assumed to have an infinite life. However, improvements to land, such as parking lots, sidewalks, landscaping, irrigation systems, and similar expenditures are capitalized separately and depreciated.

This chart illustrates how the terms associated with depreciation are related:
“Depreciable amount” is the cost of an asset, or other amount substituted for cost, less its residual value. This relationship can be illustrated by the following equation:

\[
\text{PP&E Item Cost} - \text{Residual Value} = \text{Depreciable Amount}
\]

“Residual value” is the estimated amount that an entity would currently obtain 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.

\[
\text{Depreciable Amount} \div \text{Useful Life} = \text{Yearly Depreciation}
\]

“Useful life” is the period of time over which an asset is expected to be used by the entity.

**UN System Decision**

UN Recommended Accounting Practice is to use a residual value of zero, unless at the end of the asset’s usefulness to the organization the residual value is likely to be significant.

**Note**

An item of PP&E may have a useful life that is shorter than 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 organization 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 an Organization is using to be shorter than its economic life.

The estimation of the useful life of an asset is a matter of judgment based on the experience of the Organization with similar assets or industry practice. The useful life of an item is related to how often and under what circumstances the item of PP&E will be used. Expected physical wear and tear is dependent on operational factors and environmental conditions - for example, extreme climatic conditions, such as
extreme heat, sand storms, heavy rain may deteriorate PP&E at a faster rate. Hence, the same type of PP&E could have different life expectations in different locations. The existence of a good repair and maintenance programme might extract a longer useful life from an item of PP&E.

Oftentimes obsolescence causes the useful life of an item of PP&E to be shorter than its economic life. Obsolescence may arise from changes or improvements in production or technology, but it can also arise from changes in operations, whereby in certain cases there might be no further use for a specific item of PP&E.

The following chart summarizes concepts related to useful life, and presents the key issue about when to commence depreciation of an item of PP&E.

**Useful life**

- All the following factors are considered in determining the useful life of an asset:
  - Expected usage of the asset
  - Expected physical wear and tear
  - Repair and maintenance program
  - Technical, commercial or operational obsolescence
  - Legal or similar limits in the use of the asset (such as expiry date of related leases)

**Key Issue**

Depreciation of an asset begins when the asset is available for use (this means that for e.g. items which fall in the category “construction in progress” are not depreciated) and ceases when the asset is de-recognized. Therefore depreciation does not cease when the asset becomes idle or is removed from active use and held for disposal (unless the asset is fully depreciated). Land is not depreciated, but “land improvements” are.

**7.2 Depreciation Parameters**

Depreciation can be measured using different parameters for different classes or types of PP&E. The following table illustrates what the base measurement could be for depreciation of different types of PP&E.
### UN System Decision

UN system-wide recommended accounting practice is to use years as the measurement parameter for depreciation.

Each organization will decide when to record the depreciation expense; this can be done monthly, semi-annually or at year-end only. No matter how the depreciation is recorded, depreciation expense should be pro-rated to reflect the actual period the asset was available for use during the year. For example, a satellite put into service in December should not be charged for an entire year’s worth of depreciation in the year of acquisition.

### Implementation Issue

Each organization will determine, within the recommended useful life ranges, the useful life of each “type” of PP&E, and review this periodically. Examples of possible useful lives for sub-categories of Communication and IT equipment are as follows:

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<thead>
<tr>
<th>Computers</th>
<th>Years of use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication and IT Equipment</td>
<td>3 – 7 years</td>
</tr>
<tr>
<td>Vehicles</td>
<td>Mileage of years of use</td>
</tr>
<tr>
<td>Helicopters and Aircrafts</td>
<td>Hours of operation</td>
</tr>
<tr>
<td>Machinery</td>
<td>Units processed</td>
</tr>
<tr>
<td>Buildings</td>
<td>5 – 50 years</td>
</tr>
<tr>
<td>Land</td>
<td>No Depreciation</td>
</tr>
</tbody>
</table>
Depreciation Parameters

Depreciation can be measured using different parameters, for example:

<table>
<thead>
<tr>
<th>Items</th>
<th>Parameters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computers</td>
<td>Years of use</td>
</tr>
<tr>
<td>Vehicles</td>
<td>Mileage, or years of use</td>
</tr>
<tr>
<td>Helicopters and aircraft</td>
<td>Hours of operation</td>
</tr>
<tr>
<td>Machinery</td>
<td>Units processed</td>
</tr>
</tbody>
</table>

The residual value and the useful life of assets must be reviewed at least at each annual reporting date and, if expectations differ from previous estimates, the changes must be accounted for as changes in accounting estimates in accordance with IPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors”. Such a change would be applied “prospectively”, meaning that it will affect the depreciation expense of the current period and each relevant future period.

The existence of a large number of completely depreciated assets still in use might indicate that the useful lives, which were assigned to those types of PP&E, are too short.

7.3 Depreciation Methods

IPSAS 17 allows a variety of depreciation methods which can be used to allocate the depreciable amount of an item of property, plant and equipment on a systematic basis over its useful life. The method used by an entity shall reflect the pattern in which the future economic benefits or service potential is expected to be consumed by the entity. The methods allowed by IPSAS 17 include:

1) the straight-line method results in a constant charge over the useful life of the asset;
2) the diminishing balance method results in a decreasing charge over the useful life of the asset; and
3) the units of production method results in a charge based on the expected pattern of asset use or output.

UN System Decision

UN System-wide recommended accounting policy is to use the straight line method of depreciation.
An Example of Depreciation

Lets look at an example of depreciation - it is easier to understand depreciation using a scenario with numbers.

- A vehicle is purchased for $9,000 and an additional $1,000 is paid in shipping costs.
- The vehicle is available for service at the beginning of 2010.
- Its useful life is estimated to be 5 years.
- Its residual value is estimated to $0.
- The depreciation method used is straight-line.
- At the end of its useful life, it is donated to a local non-governmental organization (NGO).

At purchase, the cost, residual value, depreciable amount, useful life, and annual depreciation charges are determined as follows:

\[
\begin{align*}
\text{Cost} & \quad \text{Residual value} & \quad \text{Depreciable amount} & \quad \text{Useful life} & \quad \text{Annual depreciation charge} \\
$10,000 & \quad - & \quad $0 & \quad $10,000 & \quad \div \quad 5 & \quad = & \quad $2,000
\end{align*}
\]

After the 1st year of use (2010), the carrying amount of the vehicle is calculated as follows:

\[
\begin{align*}
\text{Carrying amount} & \quad = \quad \text{Cost} \quad - \quad \text{Annual depreciation charge} \\
& \quad = \quad $10,000 \quad - \quad $2,000 \\
& \quad = \quad $8,000
\end{align*}
\]

After the 2nd year of use (2011), the carrying amount of the vehicle is calculated as follows:

\[
\begin{align*}
\text{Carrying amount} & \quad = \quad \text{Carrying amount after 1st year} \quad - \quad \text{Annual depreciation charge} \\
& \quad = \quad $8,000 \quad - \quad $2,000 \\
& \quad = \quad $6,000
\end{align*}
\]

**Accounting Details**

The depreciation is recorded as a Debit to “Depreciation Expense” and a Credit to “Accumulated Depreciation of PP&E”. Depreciation Expense is reported in the Statement of Financial Performance; PP&E is reported in the Statement of Financial Position net of Accumulated Depreciation of PP&E.
Break
(15 minutes)

Learning Check Points
Group Exercise
Unit 8: Impairment of PP&E

During the useful life of an item of Property, Plant and Equipment (PP&E), some unexpected events may occur (such as accidents, obsolescence) that cause a reduction in an item’s value beyond normal depreciation. In these cases an impairment loss needs to be recorded.

This Unit provides examples of different situations in the context of the UN system organizations that may cause impairment of PP&E. It also describes how to measure and record impairment and presents an illustrative example.

By the end of this unit you will be able to:

- Explain the concept of impairment of PP&E.
- Give examples of situations that lead to impairment losses according to IPSAS 21 - Impairment of Non-Cash-Generating Assets.
- Describe how impairment losses are calculated.
- Identify possible alternatives when an asset of PP&E is impaired and the respective accounting treatment.
8.1 Causes of Impairment

There are times when a UN System organization finds that items of its PP&E will not provide future economic benefit or service potential as was expected. When this happens, the value of those items must be reduced to recognize that loss.

“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. Causes of impairment include the following examples:

- **Accident** - A UN system organization’s vehicle collides with a tree.
- **Hostile Action** - An angry crowd destroys a warehouse.
- **Natural Disaster** - A typhoon destroys a building.
- **Obsolescence** - IT equipment is not compatible with the organization’s new ERP system and thus becomes obsolete before the end of its expected useful life.
- **Non-compliance** - A building that does not comply with the health guidelines because of asbestos, or land that has been found contaminated with radiation or a vehicle that is not compatible with emission and environmental standards.
- **Internal/External decision** - Construction of a building was stopped due to the identification of an archaeological discovery.
- **Decline in usage** - Medical equipment that is rarely used because a more advanced model is providing more accurate results.

**Key Impairment Concepts**

The majority of the items of PP&E within the UN system are not used to generate cash. For the recording of impairment for such assets, IPSAS 21 “Impairment of Non-Cash Generating Assets” should be used. IPSAS 21 provides that:
- An entity shall assess at each reporting date whether there is an indication that an asset may be impaired.
- If an indication exists, then the recoverable service amount is calculated.
- If the carrying amount of the item of PP&E < Recoverable service amount, an impairment loss is recorded.
- Carrying amount of the item of PP&E - Recoverable service amount = Impairment Loss.

“Recoverable service amount” and “value in use” are concepts essential to measurement of an impairment loss. “Recoverable service amount” is the higher of an item’s fair value less costs to sell and its value in use. “Value in use” is the present value of an asset’s remaining service potential.

In order to measure the remaining service potential, there are different options, for example:

- **Depreciated replacement cost approach** - what would be the cost of replacing the asset’s gross service potential?
- **Restoration cost approach** - what would be the cost of restoring the service potential of the asset to its pre-impaired level (for example, what would be the cost of repairing a car after an accident?)

A non-cash-generating asset is impaired when its carrying amount is greater than its Recoverable Service Amount.

### Accounting Details

After the recognition of an impairment loss, the depreciable amount for the impaired asset will be reduced, due to the impairment. The impaired asset’s remaining useful life may also be different. The new depreciable amount and remaining useful life will need to be determined in order to determine the depreciation expense for future years.

At each reporting date, IPSAS requires the performance of an “impairment test”, that is an assessment whether there is indication that an asset might be impaired. This implies that stocktaking procedures including physical counts and inspection of assets, as well as other oversight and internal control systems should be in place.

Also, systems should be in place that would facilitate the calculation of the recoverable service amount. For example, such systems could keep track of the costs to repair specific items and the values obtained from recent selling transactions of items in similar conditions. IPSAS requires disclosures on the events that led to material impairments and the nature of the assets impaired. When computing an impairment loss, proceeds from insurance are not to be taken into account. If a car had an accident and the damages suffered are beyond
repair, when calculating the fair value of the wrecked vehicle an Organization will only focus on the “scrap value” of the car, not the insurance proceeds.

IPSAS 21 “Impairment of Non-Cash-Generating Assets” does not address insurance proceeds.

8.2 Examples of Impairment
Let’s look at a few examples of situations where there is impairment of PP&E.

Scenario 1
The non-cash-generating vehicle used in the previous unit has a collision at the end of 2012, and cannot be used further in its wrecked state. The wrecked vehicle can be sold on the local market for $2,100. It can also be sold in a neighboring country, for $2,750 but it would cost $250 to transport it there. The wrecked vehicle’s fair value less costs to sell is $2,500.

The wrecked vehicle is sold for $2,750 in the neighboring country in 2013, netting $2,500.

The impairment loss of $1,500 ($4,000 – $2,500) is recorded in 2012; the sale is recorded in 2013. In this case there are no gains or losses from the disposal since the impairment loss recorded embodies the fair value less costs to sell and the final price for which the vehicle was sold agreed with the estimate.

Scenario 2
If the vehicle instead of being sold had been repaired and put back into use, the depreciation would have continued but at a different rate in order to accommodate the revised “carrying amount”. The following chart illustrates this scenario.
The following steps are applied to the information in the preceding scenarios to illustrate how to test for impairment and how to treat the results of the test for impairment.

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1: Calculate Vehicle Carrying Amount</td>
<td>10,000 - 6,000 = 4,000</td>
<td>Cost - Accumulated depreciation</td>
</tr>
<tr>
<td>Step 2: Determine Vehicle fair value less cost to sell</td>
<td>2,750 - 250 = 2,500</td>
<td>Fair Value - Cost to sell</td>
</tr>
<tr>
<td>Step 3: Determine Vehicle recoverable service amount</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Step 4: Determine if there is impairment</td>
<td>4,000 &gt; 2,500</td>
<td>Book Value &gt; Recoverable Service Amount</td>
</tr>
<tr>
<td>Result: Impairment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Step 5: Reduce Vehicle Carrying amount to recoverable service amount</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Step 6: Recognize impairment loss</td>
<td>1,500</td>
<td></td>
</tr>
</tbody>
</table>

The asset record for that vehicle (under scenario 1) might reflect the impaired condition in this way:
### Asset Record: PP&E – Vehicles – Serial # abc-123

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition Date</td>
<td>2 January, 2010</td>
</tr>
<tr>
<td>Acquisition Cost</td>
<td>10,000</td>
</tr>
<tr>
<td>Useful Life (years)</td>
<td>5</td>
</tr>
<tr>
<td>Residual Value</td>
<td>0</td>
</tr>
<tr>
<td>Depreciation Method</td>
<td>Straight Line</td>
</tr>
<tr>
<td>Annual Depreciation</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Depreciation Charged:</strong></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>2,000</td>
</tr>
<tr>
<td>2011</td>
<td>2,000</td>
</tr>
<tr>
<td>2012</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Impairment 2012</strong></td>
<td>1,500</td>
</tr>
<tr>
<td><strong>Disposal 2013</strong></td>
<td>2,500</td>
</tr>
<tr>
<td><strong>End of Year Carrying Amount:</strong></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>8,000</td>
</tr>
<tr>
<td>2011</td>
<td>6,000</td>
</tr>
<tr>
<td>2012</td>
<td>4,000</td>
</tr>
<tr>
<td>2013</td>
<td>2,500</td>
</tr>
</tbody>
</table>

The slide on the following page, and the brief explanation of key points, provides a general framework for analyzing management response to asset impairment, and the resulting operational and accounting activities.

**8.3 Derecognize (Derecognition will be discussed in greater detail in the next unit)**

Many organizations have a policy to abandon or dispose of severely damaged property, plant and equipment in certain classes – often vehicles, precision instrumentation, artworks, buildings that have been damaged and others. Whether or not there is an organizational policy concerning derecognition of impaired assets, there are accounting consequences to derecognition.

**Accounting Details**

In the example of the impaired vehicle, you saw the process of writing down the asset value, recognizing the impairment loss, but there was no loss on sale of the asset since the net disposal proceeds were equal to the written-down carrying cost. If the vehicle had become worthless, and was abandoned, then the recoverable service amount would have been $0 and the impairment loss would have been $4,000. If the net disposal proceeds were less than the written down carrying amount, there would have been a loss on sale.
8.4 Write Down
Sometimes when an asset is impaired, it is still functional, but not fully. In this case, management may decide to simply continue to use the asset without repair. If the vehicle in the example above was still able to perform some functions, perhaps carrying supplies at low speeds for short distances, management might decide simply to keep it for that use. In this case, it is possible that not only has its value in use been reduced, but its useful life might be reduced as well. If we assume that its value in use has been reduced to $2,500, but it is expected to be useable in its current state for only one more year instead of two more years, then its useful life should be reduced to one year and the depreciation charge in 2013 should be $2,500 instead of $2,000.

8.5 Repair
There are three possible outcomes from repairs made to the vehicle in the previous example:

1) Repair it to its previously depreciated condition,
2) Repair it to less than its previously depreciated condition, and
3) Repair it to better than its previously depreciated condition.

Under each of these outcomes, the impairment loss would be recognized first, regardless of the extent of the repairs made.

1) If we assume that the vehicle is repaired to its previously depreciated condition, then the cost of the repairs are expensed in the current period and the pre-impairment carrying amount will be depreciated over the two remaining years of service.
2) If we assume that the vehicle is repaired to less than its previously depreciated condition, the cost of the repairs is expensed in the current period, the impairment is expensed in the current period, and the resulting new carrying amount (recoverable service potential) will be depreciated only over the new remaining years of service. For example, if it costs $500 to make the repairs, but there was now only one remaining year of service, then the depreciation charge in 2013 should be $2,500 instead of $2,000. If the remaining useful life continued to be two more years, then the depreciation charge would be $1,250 for each of those years.

3) If we assume that the vehicle is repaired to better than its previously depreciated condition, either improving its functionality or extending its life beyond the original expectation, the cost of the repairs is added to the written-down carrying amount, and the resulting new carrying amount will be depreciated over the new remaining years of service. For example, if it cost $2,000 to make the repairs, but because of the repairs made there was now three additional years of service, then the new carrying amount would be $4,500, and the depreciation charge in each year 2013 – 2015 should be $1,500.

Accounting Details

When there is an indication that property, plant and equipment may be impaired, it may indicate that the remaining useful life, the depreciation method or the residual value for the asset in question needs to be reviewed and adjusted in accordance with IPSAS 17 - even if no impairment loss is recognized for the asset.

Indications that property, plant and equipment may be impaired come from both external sources and internal sources.

External information that may indicate impairment include:

a. cessation, or near cessation, of the demand or need for services provided by the asset; and

b. significant long-term changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal or government policy environment in which the entity operates;

External sources of information include appraisers, suppliers, vendors, manufacturer associations, equipment sector trade publications, classified advertising, equipment brokers, real estate brokers, published statistical sources, and internet searches.
Internal information that may indicate impairment include:

a. evidence of physical damage to an asset;

b. significant long-term changes with an adverse effect on the entity which have taken place during the period, or are expected to take place imminently, which results in:
   1) the asset becoming idle,
   2) plans to discontinue or restructure the operation to which an asset belongs, or
   3) plans to dispose of an asset before the previously expected date;

c. a decision to halt the construction of the asset before it is complete or in a usable condition; and

d. internal reporting which indicates that the service performance of an asset is, or will be, significantly worse than expected.

8.6 Reversal of Impairment Losses

Implementation Issue

Organizations must assess at each reporting date whether there is an indication that the impairment loss recognized in prior periods may no longer exist. For example, a decision to resume construction of an asset that was previously halted before it was completed might be such an indication. When a reversal of impairment is required, the remaining useful life, depreciation method or residual value will need to be adjusted.
Unit 9: Derecognition of PP&E

When an item of Property, Plant and Equipment is no longer needed, has been stolen, sold, donated or retired from activity, it should be removed from the Financial Statements, this is called “derecognition of PP&E”.

This unit provides examples of situations in the UN System that cause derecognition and explains how to calculate gains and losses on disposal as well as some practical implications.

By the end of this unit you will be able to:

- Give examples of situations in the UN system context that lead to derecognition.
- Explain how gains or losses realized upon de-recognition of PP&E are calculated.
- Identify practical implications related to de-recognition of PP&E.
9.1 What is Derecognition?
Derecognition of property, plant and equipment is the removal of an item of property, plant and equipment from the Statement of Financial Position. An item of property, plant and equipment is removed from the accounts and the Statement of Financial Position when the following situations occur:

a. sale,
b. transfer/donation,
c. abandonment,
d. theft,
e. destruction,
f. reported loss,
g. inventory discrepancy, or

Examples relevant to UN System organizations include:
- **Sale** - used furniture in the Headquarters office is sold in the local market.
- **Transfer** - used IT equipment is transferred from one Peacekeeping Mission that is closing and recognised in a “start-up” mission.
- **Donation** - a country office’s self-constructed community water system is turned over to a local community for operation.
- **Abandonment** - an administrative building is deserted because of unrest.
- **Theft** - medical equipment is stolen from an Organization field clinic.
- **Destruction** - a vehicle is destroyed by an angry mob.
- **Reported loss** - a local contractor reports the loss of a laptop (property of a UN System organization).
- **Inventory discrepancy** - shortages in PP&E discovered through physical verification and evidence of theft cannot be established.

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

9.2 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 derecognized. Gains from derecognition are not included in revenue from normal operations, they are recognized as a separate line item reported on the Statement of Financial Performance.

The following formula summarizes how gains or losses from derecognition are calculated.

\[
\text{Net Disposal Proceeds} - \text{Carrying Amount} = \text{Gain/Loss from Derecognition}
\]
Sometimes PP&E items are set aside for disposal but it can take considerable time until the disposal process actually occurs. For purposes of IPSAS reporting:

- appropriate accounting policies, procedures and systems should be in place,
- responsible staff should be trained in them, and
- asset management staff and accounting staff should co-ordinate their activities in order to ensure that all items of PP&E for which no economic benefit or service potential is expected are properly derecognised from the statement of financial position.

If there are still some expectations regarding continuing service potential (for example an item will be transferred within a specific organization or revenue is expected from the sale), in that case, depreciation continues to be calculated and the item is only derecognized when sold or transferred. The following chart summarizes how to account for PP&E under consideration for disposal.

---

**PP&E item set aside for disposal**

- **Economic benefits or service potential still expected?**
  - **YES**
    - Continue to depreciate until disposal
    - Derecognise when disposal occurs
  - **NO**
    - Derecognise immediately
Case Study
Group Exercise
Unit 10: Disclosure and Reporting of PP&E

Understanding the disclosure and reporting requirements for Property, Plant and Equipment (PP&E) is important for both accountants and staff with property management responsibility. While accountants are required to account and report for PP&E in the financial statements in an IPSAS-compliant manner, the reported figures will be derived from information maintained by property managers in the assets register. In order to avoid qualifications in the audit opinion, accountants and asset managers will need to co-ordinate efforts to ensure accurate and complete reporting of PP&E and to take immediate action to address any audit comments and observations.

By the end of this unit you will be able to:

- Describe how PP&E is shown in the financial statements.
- Apply the formula to reconcile carrying amounts of PP&E between the beginning and the end of the financial statement reporting period.
- Identify disclosures required to be presented for each class of PP&E.
- Identify what must be disclosed concerning PP&E that is not recognized due to use of transitional provisions.

This Unit describes how PP&E is reported both on the face of the financial statements and in the notes. It also identifies common audit issues regarding PP&E.
IPSAS provides that the disclosures concerning property, plant and equipment must be made in the following components of the general purpose financial statements:

1) the Statement of Financial Position (the Balance Sheet) – shows all items of assets and liabilities as at the end of the financial period and shows a breakdown of the net asset position.
2) the Statement of Financial Performance (the Income Statement) – shows all items of revenue and expense recognized in a financial period and the surplus or deficit of total revenues vs. expenses.
3) the Cash Flow Statement – shows how cash was used by the organization during the period, and linking the two previous financial statements; and
4) the Notes to the Financial Statements – shows important and useful details of the summary information provided in the Financial Statements.

The above Statements must be prepared annually by organizations in the UN system in order to comply the requirements of IPSAS.

10.1 Statement of Financial 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. The following extract illustrates how PP&E should be reported on the face of the Statement of Financial Position.

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>NOTES</th>
<th>31 DEC 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>4</td>
<td>200</td>
</tr>
<tr>
<td>Other financial Assets</td>
<td>6</td>
<td>400</td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>7</td>
<td>1,550</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>8</td>
<td>300</td>
</tr>
<tr>
<td>Other non-current Assets</td>
<td>9</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total Non-current Assets</strong></td>
<td></td>
<td><strong>2,600</strong></td>
</tr>
</tbody>
</table>

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.

10.2 Statement of Financial Performance
Disclosure in the Statement of Financial Performance related to PP&E include depreciation and impairment losses in the “Expenses” section of that statement (if material, impairment
losses can be shown as a separate line item, otherwise they will be recorded under “Other expenses”). Gains from sale of PP&E shall not be classified as revenue. The following extract illustrates how PP&E should be reported on the face of the Statement of Financial Performance.

<table>
<thead>
<tr>
<th>EXPENSES</th>
<th>NOTES</th>
<th>31 Dec 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee benefits expenses</td>
<td>10</td>
<td>200</td>
</tr>
<tr>
<td>Consultants</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>Grants and other transfers</td>
<td>11</td>
<td>20</td>
</tr>
<tr>
<td>Supplies and consumables used</td>
<td></td>
<td>60</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>7</td>
<td>200</td>
</tr>
<tr>
<td>Other expenses</td>
<td></td>
<td>90</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td></td>
<td>620</td>
</tr>
<tr>
<td>Surplus/deficit from operating activities</td>
<td></td>
<td>90</td>
</tr>
<tr>
<td>Gains/(Losses) on sale of PP&amp;E</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Total non operating revenue/(expense)</td>
<td></td>
<td>95</td>
</tr>
</tbody>
</table>

10.3 Cash Flow Statement (and associated notes)
UN System organizations will have the option to use either the Direct Cash Flow Method or the Indirect Cash Flow Method for reporting their cash flows in the financial statements. The difference between the two methods is in the reporting of the Cash Flow from Operating Activities. According to the Indirect Method, the Surplus or Deficit for the Period needs to be adjusted by any “non cash” activities. In the case of PP&E, these “non cash” activities include:

- Depreciation and Impairment Losses (added)
- Gains from the sale of PP&E (subtracted)
- Losses from the sale of PP&E (added)

The Cash Flow from Investing Activities (which shows the cash outflows for purchases of PP&E and cash inflows from any sales of PP&E) is the same under both methods. The following extract illustrates how PP&E should be reported on the face of the Statement of Cash Flows and how the associated notes are disclosed in the Notes to the Financial Statements.
Notes to the Cash Flow Statement (associated with the Statement of Cash Flows)

Property, Plant and Equipment: During the period, the [Organization] acquired property, plant and equipment with an aggregate cost of $975,000 of which $300,000 refers to land which was acquired by means of a contribution in kind by member states. Cash payments of $675,000 were made to purchase property, plant, and equipment.

10.4 Notes to the Financial Statements (samples)

Note 7- Property, plant and equipment

Property, plant and equipment is carried at cost less accumulated depreciation and impairment.

Heritage assets are not recognized.

In most instances, an item of property, plant and equipment is recognized at its cost. When an asset is donated, it is recognized at fair value as at the date of acquisition.

On initial recognition, property, plant and equipment is recognized at cost.

Additions

The cost of an item of property, plant and equipment is recognized as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the [Organization] and the cost of the item can be measured reliably.

Disposals

Gains and losses on disposal are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses on disposal are included in the statement of financial performance.
**Subsequent costs**
Costs incurred subsequent to initial acquisition are capitalized only when it is probable that future economic benefits or service potential associated with the item will flow to the [Organization] and the cost of the item can be measured reliably.

**Depreciation**
Depreciation is provided on a straight-line basis on all property, plant and equipment other than land, at rates that will write off the cost of the assets to their estimated residual values over their useful lives. The useful lives of major classes of assets have been estimated as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Useful Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communications and IT equipment</td>
<td>3-7 years</td>
</tr>
<tr>
<td>Vehicles</td>
<td>3-10 years</td>
</tr>
<tr>
<td>Furniture and fixtures</td>
<td>5-12 years</td>
</tr>
<tr>
<td>Leasehold improvements</td>
<td>Shorter of lease term and useful life</td>
</tr>
<tr>
<td>Buildings</td>
<td>5-50 years</td>
</tr>
</tbody>
</table>

The residual values and useful lives of assets are reviewed and adjusted, if applicable, at each financial year-end.

**Contractual commitments**
There are contractual commitments for the acquisition of Vehicles ($50,000) and Communications and IT equipment ($80,000).

**Impairment Losses**
Accidents caused impairment losses to vehicles amounting to $10,000. The recoverable service amount of the assets refer to the fair value less costs to sell and were determined by reference to an active market.

Additional Information [if relevant for users for Financial Statements)

**Idle property**
PP&E amounting to $40,000 is currently idle.

**Fully depreciated PP&E**
PP&E amounting to a gross carrying amount of $800,000 is fully depreciated but still in use.

PP&E is carried at cost. Instances where the fair value of PP&E materially differs from the carrying amount include Buildings, with a carrying amount of $0 and a fair value of $100,000.
Reconciliation of Beginning and Ending Balances of PP&E
IPSAS 17 requires disclosure in the notes to the financial statements showing reconciliation between the current period beginning balances of classes of PP&E with their ending balances, so that financial statement users can understand the changes in the position of PP&E over the period. Additionally, this reconciliation provides information about the composition of PP&E (classes and respective amounts) on the face of the Statement of Financial Position.

<table>
<thead>
<tr>
<th></th>
<th>Communications and IT Equipment</th>
<th>Vehicles</th>
<th>Furniture and Fixtures</th>
<th>Leasehold Improvements</th>
<th>Buildings</th>
<th>Land</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost 1-Jan 2012</td>
<td>100</td>
<td>450</td>
<td>120</td>
<td>60</td>
<td>800</td>
<td>200</td>
<td>1,730</td>
</tr>
<tr>
<td>Accumulated Depreciation and impairment 1/1/12</td>
<td>50</td>
<td>100</td>
<td>30</td>
<td>10</td>
<td>725</td>
<td>0</td>
<td>915</td>
</tr>
<tr>
<td>Carrying Amount 1/1/12</td>
<td>50</td>
<td>350</td>
<td>90</td>
<td>50</td>
<td>75</td>
<td>200</td>
<td>815</td>
</tr>
<tr>
<td>Current Year Additions</td>
<td>500</td>
<td>175</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>300</td>
<td>975</td>
</tr>
<tr>
<td>Current Year Disposals</td>
<td>0</td>
<td>0</td>
<td>50</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>Current Year Impairments</td>
<td>0</td>
<td>10</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Current Year Depreciation</td>
<td>40</td>
<td>50</td>
<td>5</td>
<td>10</td>
<td>75</td>
<td>0</td>
<td>180</td>
</tr>
<tr>
<td>Cost 12/31/12</td>
<td>600</td>
<td>625</td>
<td>70</td>
<td>60</td>
<td>800</td>
<td>500</td>
<td>2,655</td>
</tr>
<tr>
<td>Accumulated Depreciation and impairment 12/31/12</td>
<td>90</td>
<td>160</td>
<td>35</td>
<td>20</td>
<td>800</td>
<td>0</td>
<td>1,105</td>
</tr>
<tr>
<td>Carrying Amount 12/31/12</td>
<td>510</td>
<td>465</td>
<td>35</td>
<td>40</td>
<td>0</td>
<td>500</td>
<td>1,550</td>
</tr>
</tbody>
</table>

In order to be able to claim IPSAS compliance, it is essential that all requirements in the transitional provisions are met during the transition period. In particular, the reporting entity must make sure that any additional required disclosures are provided.
Unit 11: Common Audit issues

In order to support a smooth audit of PP&E accountants and managers will need to co-ordinate efforts to ensure accurate and complete reporting of property, plant and equipment, and to take immediate action to address any audit comments and observations. Not all misstatement in the financial statements have the same impact. Some will lead to comments in the management letter, other misstatements if material can lead qualifications in the audit opinion.

This Unit provides a summary of several aspects of audit for PP&E. It addresses the following aspects of audit:

By the end of this unit you will be able to:

- Summarize common audit issues relating to general audit objectives;
- Explain issues relating to preparation for audit;
- Identify audit issues relating to first time adoption of IPSAS; and
- Recognize common audit procedures used for verification of intangible assets.
11.1 Steps to prepare for an audit

In order to avoid qualifications in the audit opinion and help the audit to go smoothly there are a number of steps that management and staff can take. For the specific case of audit of Property, Plant and Equipment these steps include:

- having supporting information and schedules ready:
- maintaining audit trails
- understanding the auditor’s objectives

Having supporting information and schedules ready:

Supporting information available for the auditors should include the following:

- Reconciliation of opening and closing balances of each class of asset
- Copy of the physical count report and procedures
- Reconciliation of the physical count report to the asset register
- List of write-offs/write-downs (impairments)
- Schedule of spending subsequent to purchase, showing which spending has been capitalized in accordance with the policy on capitalization
- Schedule of revenue and expense recognized from the sale of assets
- Valuation reports where applicable

Maintaining audit trails

Auditors need to be able to track from the financial statements back to the underlying transactions and events. This process is greatly facilitated by the use of an integrated IT/ERP system, but if the Organization does not have one, a master schedule of posting entries to the Financial Statements should be maintained.

Understanding the auditor’s objectives

Management and accounting staff should understand the objectives of the auditors and be aware of common audit issues. They should take steps to avoid the occurrence of items that would cause issues with the audit.

Common Audit Procedures for Initial IPSAS Adoption

When auditing opening balances at first time issuance of IPSAS-compliant Financial Statements, auditors are likely, in particular, to:

- require a discussion for the methodology used, by asset class, and
- require evidence to support opening balances.

Methodology for developing opening balances

Management and accounting staff should prepare a narrative of the methodology used to survey PP&E and assign it initial balances at adoption. This should be prepared on a class-by-class basis and be as comprehensive as possible. Appropriate personnel should be available to discuss all aspect of this with the auditors.
Evidence to support opening balances
Evidence supporting the preparation of opening balances of PP&E should be well organized, readily accessible, and appropriately categorized by level of summarization. Evidence should include valuation reports, copies of confirmations from asset holders that asset registers are accurate and complete, evidence of physical verification and management review for ownership, accuracy and completeness.

Other Common Audit Procedures Concerning PP&E
Auditors will conduct a number of audit procedures in their audit of the financial statements. This section will discuss some of the common ones that UN System organizations can expect.

Analytic and Substantive Procedures
Analytic and substantive procedures auditors can be expected to conduct to verify PP&E reporting and disclosure include:

- General analytic procedures comparing preceding year balances and ratios with current year balances and ratios.
- Testing existence and completeness of items of property, plant and equipment.
- Testing construction in progress for capitalization of costs, reasonableness of costs, stages of completion versus contractor payment, and impairments/cost recoverability.

Review of Policy and Procedures
Auditors will review Organization policies and procedures for a number of aspects pertaining to PP&E which can be expected to include:

- **Acquisition** - confirm that acquisitions are authorized in line with the accountability framework of the Organization.
- **Required maintenance, impairments, etc.** – confirm that required maintenance, impairments, reversal of impairments, repairs, major refurbishments, and disposals of property, plant and equipment, and their accounting treatment, have process integrity.
- **Disposals** – confirm that policies and procedures for disposals of items of PP&E and their accounting treatment, have process integrity. Auditors will confirm that disposals are authorized and documented in line with approved policy. They will evaluate proper calculation of gain/loss on disposals and receipt of funds if applicable.
- **Internal controls** – Review internal control policies and procedures and evaluate processes for appropriate control and safeguarding of property, plant and equipment (such as locks on doors, car security measures, etc).
11.2 Common Audit Findings to Avoid

Management should take steps to avoid the following common audit findings related to PP&E in the areas of:

- **Valuation** – common audit findings in the area of assets not being recorded at an appropriate carrying value are often due to:
  - Pending impairments not being recorded
  - Depreciation rates and useful lives not reviewed regularly
  - Not all directly attributable costs being capitalized at acquisition
  - Using the donor’s value estimate for donated items

- **Completeness** - common audit findings in the area of accounts and balances not being complete are often due to:
  - Records not being complete
  - Self-constructed assets (such as roads, infrastructures and improvements to buildings) not being reported
  - Major upgrades not being capitalized
  - Assets which are “in transit” but already are controlled by the organization not being reported

- **Existence** - common audit findings about reporting assets that do not exist are often due to:
  - Missing disposal information
  - Unresolved discrepancies between physical asset verification and asset register (items being reported that no longer exist)
- **Rights and Obligations** - common audit findings about reporting assets that do not pertain to the entity at a given date are often due to reporting assets that are not under the control of the organization.

- **Presentation and disclosure** - common audit findings about assets not being disclosed or classified in accordance with IPSAS are often due to:
  - Disclosures required by IPSAS being missing
  - Beginning balances not matching prior period ending balances
This Unit presents a list of Frequently Asked Questions (FAQ's) in the area of PP&E and a Summary of key learning points.
Below you will find answers to common questions related to IPSAS implementation in the area of PP&E.

1- How will IPSAS influence the management of fully depreciated items of PP&E?
   - IPSAS does not provide guidance on how to manage assets. It is up to the asset managers to determine if fully depreciated assets need to be replaced or can continue to be used. If there is no operational need to use a particular type of asset, these do not need to be replaced.
   - Fully depreciated assets should still be tracked until disposal, even if not in use.
   - If there are considerable amounts of assets which are fully depreciated and still being used this could be an indication that the useful life was not properly estimated or it could indicate that the organization is operating with old assets and perhaps the policy for asset replacement should be reviewed.
   - IPSAS encourages organizations to disclose the gross carrying amount of any fully depreciated PP&E that is still in use in cases where the users of financial statements would find this information relevant for their needs.

2- What is the IPSAS compliant treatment of idle assets?
   - Idle assets of PP&E are assets that are currently not being used. IPSAS does not provide guidance on how to manage idle assets. It is up to management to decide based on operational needs.
   - When an asset becomes idle, IPSAS requires the continuation of depreciation.
   - If the asset is idle because it is no longer required in the location, this could be an indication that the asset should be sold, transferred or otherwise disposed of.
   - In instances where an asset has been idle for a significant period of time and management anticipates that the asset is obsolete, the asset should be impaired.
   - IPSAS encourages organizations to disclose the carrying amount of temporarily idle PP&E.

3- Will the establishment of a capitalization threshold for PP&E influence asset management?
   - No. The capitalization threshold for recognition of PP&E does not mean that assets under the threshold will no longer be tracked. It is up to management to decide what assets under the capitalization threshold should be tracked for custodial purposes. An asset management threshold may be set by an organization at a level lower than the capitalization threshold.
   - PP&E assets that are below the recognition threshold are not reported in the Financial Statements.
4- Why are physical counts of PP&E so important in an IPSAS environment? What key issues should be considered when performing physical counts?

- Physical counts help to validate data in the asset register - both in terms of quantity and valuation. For example, during a physical count of PP&E it can be found that some assets are damaged or became obsolete requiring their value to be adjusted based on an impairment test. Such adjustments are reflected in the IPSAS compliant financial statements.
- Key issues when performing this procedure:
  i. Staff involved in the physical count should be independent from the staff that are is normally responsible for safeguarding or reporting on assets.
  ii. Discrepancies between the physical count and asset register should be promptly investigated.
  iii. There should be a physical and accounting cut-off to ensure that asset records at year-end are complete and exclude transactions (additions, disposals, impairments etc) that pertain to the following financial period.
  iv. Organizations can expect auditors to be present observing year-end physical counts.

5- Will beginning balances of PP&E be audited?

- On the first year of IPSAS compliance, IPSAS does not require the presentation of comparative balances. Nevertheless, beginning balances of PP&E will have to be obtained to comply with Note disclosures (reconciliation of beginning and ending balances). When issuing an opinion on the Financial Statements auditors are likely to require evidence supporting beginning balances of PP&E.

6- What is the IPSAS-compliant treatment of transportation costs?

- Initial transportation costs should be capitalized since IPSAS requires capitalization of all directly attributable costs necessary to bring the asset to the location and condition for it to be capable of operating in the manner intended by management. IPSAS does not address how freight costs in one single shipment should be pro-rated among different classes or different items of PP&E. However, each organization will set guidelines on this.
- Recognition of costs in the carrying amount of an item of PP&E ceases 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 excluded from the carrying amount of that item. So for instance, costs of relocating or reorganizing part or all of the entity’s operations should not be capitalized.

7. At what stage does an organization need to know if the item being acquired is PP&E?

- The first question that needs to be addressed is: is the item PP&E or inventory? Ideally at the stage of raising a requisition and issuing the respective purchase order, it should be known if the item being procured and acquired is PP&E or inventory. Some items can be considered either PP&E or inventory depending on the circumstances. Vehicles, for instance, are generally considered PP&E, however, vehicles being held by an organization before being distributed in the context of a project implementation are considered inventories, since they are expected to be distributed within one accounting period (they are considered current assets). As soon as it is known if the item is PP&E or inventory this should be reflected in the fixed asset register and accounting system, since the IPSAS compliant accounting treatment for these two different types of assets is completely different— for instance, the depreciation of PP&E should start being recorded as soon as the item is available for use and it should follow the approved scheme of useful life, whereas inventory should be expensed when it is used, distributed or sold.

- If the item is not considered inventory, the next question to address is: does the item fall under the capitalization threshold? Depending on the approved threshold for recognition and policy on asset grouping, an item can be recorded as PP&E or expensed on acquisition. Both the recognition threshold and the policy on asset grouping should be embodied in the system so the decision to capitalize or expense on acquisition requires less “professional judgment” than the distinction between PP&E and inventory.

Key Learning points

Unit 1 - Course Overview

- No key points.

Unit 2 - Course Introduction

- PP&E includes assets held for use in the production or supply of goods and services which are expected to be used more than one reporting period.

- Examples of PP&E in the UN System context include buildings, cars, furniture, trucks, satellites, specialized equipment, etc.

- Throughout the PP&E business cycle different events occur that impact the financial statements, from the initial recognition, the usage that causes depreciation, accidents or other events that cause impairment, repairs and maintenance vs. major upgrades, and finally the disposal leading to derecognition.
Unit 3 - Changes, Benefits and Challenges
- Currently, under UNSAS, PP&E is expensed when the Purchase Order is issued, hence there is no depreciation or impairment expense. Under IPSAS, PP&E (including "self-constructed assets"), is capitalized and depreciated over its useful life. Major overhauls are capitalized, impairment losses are recognized in the period they occur, and there are extensive disclosures required in the Notes including reconciliation of beginning and ending balances;

- The major benefits expected from adoption of IPSAS 17 include:
  - Existence of more reliable and transparent information regarding PP&E which will support better decision making;
  - Enhanced oversight of PP&E which supports more efficient service delivery
  - Better capital planning derived from the periodic review of useful lives and tests of impairment

- Challenges will be found at different stages:
  - At initial adoption:
    - survey and valuation to obtain beginning balances and ensure completeness of asset register;
    - accounting and reporting policies (threshold, asset groupings, useful lives within ranges, etc);
    - processes and workflow re-engineering;
    - training and communications
  - Subsequent to initial adoption:
    - Tests of impairment, reviews of useful lives, robust internal control mechanisms
    - Follow up on audit findings and observations

Unit 4 - Classification of Property, Plant and Equipment
- Approved classes include:
  - Communications and IT Equipment
  - Vehicles
  - Furniture and Fixtures
  - Leasehold Improvements
  - Buildings
  - Land
  - (Additional classes possible for other material groups of assets)

- Heritage assets are not recognized.

Unit 5 - Recognition of Property, Plant and Equipment
The maximum threshold for capitalization is $5,000

Lower value items might still need to be tracked but are only capitalized if they fall under the category of “group assets”

In some instances it is not clear who has “control” over a specific item of PP&E, since legal ownership is not necessary to have control.

**Unit 6 - Measurement at and subsequent to acquisition**

- **Measurement at initial recognition:**
  - Purchased PP&E: capitalize purchase price + freight/insurance + installation/assembly and any other directly related costs
  - Self-constructed PP&E:
    - Capitalize: direct materials + labor + professional fees + testing + any other directly related costs
    - Expense: administration costs + relocating and moving + scheduled maintenance + any costs of incidental operations
  - Donated PP&E: capitalize fair value
  - Leases:
    - *Finance Lease*: capitalize lower of fair value or present value of lease payments.
    - *Operating Lease*: capitalize major leasehold improvements to buildings

- **Measurement subsequent to initial recognition:** the approved policy for the UN System is to measure PP&E at cost (no revaluation)

**Unit 7 - Depreciation of Property, Plant and Equipment**

- Subsequent expenditure: capitalize major improvements, expense repairs and maintenance

**Unit 8 - Impairment of Property, Plant and Equipment**

- All PP&E needs to be depreciated (except land), when it becomes available for use.
- In the UN System Organizations, PP&E will be depreciated under the straight line method over its useful life, using a residual value of zero.

**Unit 9 - De-recognition of Property, Plant and Equipment**

- During the useful life of an item of PP&E, some events might occur that cause a loss in the future economic benefits or service potential of the item, such as accidents, hostile action, improvements in technology leading to obsolescence etc.
- Each Organization will have to assess at each reporting date if there is an indication of impairment (the recoverable service amount being lower than the item’s carrying amount) – in that case an impairment loss is recorded or the
remaining useful life, depreciation method or residual values will need to be adjusted.
- **PP&E is derecognized:**
  - when no future economic benefits or service potential is expected from its use or disposal (for e.g. the item will be scrapped or donated)
  - on disposal (for e.g. an item that will be sold is de-recognized only when the sale happens and continues to be depreciated until that moment)

**Unit 10 - Disclosure and Reporting of Property, Plant and Equipment**
- The carrying amount of all classes of PP&E is shown in a single line as a non-current asset in the Statement of Financial Position.
- Depreciation and Impairment expenses as well as gains or losses from disposal are shown in the Statement of Financial Performance
- Significant Note Disclosures include: reconciliation between beginning and ending balances per class of PP&E, accounting policies such as useful lives, contractual commitments, impairment losses and any additional information deemed relevant for the users of the Financial Statements.

**Unit 11 - Common Audit Issues**
- The carrying amount of all classes of PP&E is shown in a single line as a non-current asset in the Statement of Financial Position.
- Depreciation and Impairment expenses as well as gains or losses from disposal are shown in the Statement of Financial Performance
- Significant Note Disclosures include: reconciliation between beginning and ending balances per class of PP&E, accounting policies such as useful lives, contractual commitments, impairment losses and any additional information deemed relevant for the users of the Financial Statements.
- There are a number of steps that can help the audit go smoothly and avoid qualifications in the audit opinion, including having schedules ready, maintaining audit trails and understanding the auditor’s objectives as well as keeping supporting evidence for beginning balances.
- Common audit issues in the PP&E area include improper valuation, records not being complete, assets being reported that do not exist or are not under control of the entity and assets not being properly disclosed or classified in accordance to IPSAS.
Course Evaluation

Evaluation of course by participants

EVALUATION

☑ Outstanding
☐ Very Good
☐ Satisfactory
☐ Marginal
☐ Unsatisfactory
Course Assessment

Assessment of participants for certificate