Professional Skills - Topic 4

International Accounting Standard IAS 16

Explain The Nature and Purpose of this Document and Provide A Critical Evaluation

The International Accounting Standards Committee (IASC) was founded in 1973 and comprises of 34 International Accounting Standards. IAS 16 deals with property plant and equipment, examples of other IAS' are 1, which provides the framework for the Preparation of Financial Statements, and 2, which describes how to deal with Inventories. Much revision of these accounting standards has taken place, in December 1993 IAS 16 was revised as part of a project on 'Comparability and Improvements of Financial Statements.' More recently revisions have occurred to ensure consistency with other standards and to keep it up to date with amendments, for example in July 1997 when IAS 1 was approved, one of the paragraphs in IAS 16 was changed. These standards are a guideline to ensure consistency amongst numerous nations. It is also important that financial reporting (the product of financial accounting) is accessible to all users of the information for example, managers, investors, employees, suppliers, the government and the public. Accounting is the process of identifying, measuring, recording and communicating economic transactions. Measurement is normally made in monetary terms, and the accountant will prepare records in the form of financial statements such as a profit and loss account and a balance sheet. It is therefore necessary that items are placed correctly so as to make the financial information understandable; IAS 16 illustrates how to deal with items of property, plant and equipment.

The main principles within this accounting standard is the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them. It is necessary to establish however what exactly property, plant and equipment are. They are tangible assets that are held by an enterprise for use in the production or supply of goods or services, for rental to others or for administrative purposes. They are also expected to be used during more than just one accounting period. In order to describe the nature and purpose of the document containing IAS 16 it is necessary to summarize its contents. The document implies that property, plant and equipment (PPE), should be recognised when (a) it is probable that future benefits will flow from it, and (b) its cost can be measured reliably. It also says that initial measurement should be at cost and subsequently, the benchmark treatment is to use depreciated cost but the allowed alternative is to use an up-to-date fair value.

Depreciation features to a great extent in this accounting standard. Depreciation is the measure of the cost or revalued amount of the economic benefits of a tangible fixed asset that have been consumed during a financial period. In relation to IAS 16, it deals with the systematic allocation of the depreciable amount of an asset over its useful life. The document states that long-lived assets other than land are depreciated on a systematic basis over their useful lives and that the depreciation base is cost less estimated residual value. The depreciation method should reflect the pattern in which the asset's economic benefits are consumed by the enterprise, if assets are revalued, depreciation is based on the revalued amount. Finally, the useful life should be reviewed periodically and any change should be reflected in the current period. Significant costs to be incurred at the end of an assets useful life should be reflected as an expense.

The document also considers how re-valuations should be dealt with, it says that they should be made with sufficient regularity such that the carrying amount does not differ from that which would be determined using fair value at the balance sheet date. If an item of PPE has been revalued the entire class to which the asset belongs must be revalued and revaluations should be credited to equity. Decreases in valuation should be charged to income unless reversing a previous credit to equity. Other factors covered in the document are as follows. If an assets recoverable amount falls below its carrying amount (the balance sheet value of an asset or liability), the decline should be recognised and charged to income. Gains or losses on retirement or disposal of an asset should be calculated by reference to the carrying amount and finally the document says that required disclosures are, reconciliation of movements, capital commitments, items pledged as security and a change in revaluation surplus.

The nature of this document is very formal because it is a form of legislation that must be followed internationally, it can be described as accounting law, so it is an informed description of what to do and what not to do when preparing final accounts. It is also very detailed, it states any other accounting standard that a particular issue may clash with, and give details of which one supersedes the other, for example, when establishing the cost of an asset held by a lessee under a finance lease, it informs us that it is determined using the principles set out in IAS 17. There is a great emphasis on time; this is because plant, property and equipment are all capital and therefore more prone to depreciation. It specifies exactly how and when measurements should be made, and then how these measurements are to be dealt with over a longer period of time. This accounting standard is however quite easy to understand, it is clear, concise and informative. This is a good thing as there should not be any misunderstanding amongst accountants as to how any of the items must be placed in the final accounts. It is sorted into sixty-eight relatively short paragraphs so that it is well structured and easy to read.

The existence of this document is of paramount importance, as is any accounting standard. In the accountancy profession, there are four main characteristics of financial information that make it useful, relevance, reliability, comparability and understandability. It is because of these standards that these features exist in the working world. Relevance implies that the information has the ability to influence decisions and thus has two underlying features, predictive values and confirmatory values. The former relates to the use of information to forecast future finances, whilst the latter implies the use of information to verify decisions made in the past. The concept of reliability implies that the information is complete and faithfully represented, furthermore, it must be relied upon sometimes by enterprises all over the world so if it has been set out using IAS guidelines then it is reliable. Comparability is necessary to allow accounts to be compared not only with past accounts but also with those of other companies so that the current status and the progress of the company can be continually assessed; this consequently requires a degree of consistency and disclosure. Understandability suggests that the financial reports must be readily comprehensible by its users who are assumed to have a reasonable knowledge of business and economic activities. The presence of this accounting standard therefore has a great purpose in the accountancy profession and on an international scale.

There are however some downsides to an accounting standard like IAS 16. Firstly there is a lot of information in it, so accountants have to be aware of every detail in order to keep to the guidelines. Parts of it can be a little bit complex, especially where it is necessary to refer to another standard in a situation where there has been an amendment or revision for example paragraph sixty-eight says 'This standard supersedes IAS 16, Property, Plant and Equipment, approved in 1993', in addition, in paragraph four, it indicates that one must refer to IAS 15 for 'Information Reflecting the Effects of Changing Prices'.

To conclude, International Accounting Standards are of the utmost importance as a form of regulation of financial reporting. IAS 16, Property, Plant and Equipment is in itself very important as it concerns items that usually make up the most substantial part of the final accounts in terms of monetary value. In my opinion although it does have a few down points, any form of regulation that is important has to be quite detailed and thorough. The contents are all relevant and clear, containing definitions where necessary and references as an aid throughout. If institutions and accountants continually follow these regulations then financial reporting for this sector of the final accounts of enterprises should be relevant, reliable, understandable and comparable.