

## IAS -16 QUESTION

**Q-1**

Extravagant Inc. is installing a new plant at its production facility. It has incurred these costs:

	\$
1. Cost of the plant (cost per supplier's invoice plus taxes)	2,500,000
2. Initial delivery and handling costs	200,000
3. Cost of site preparation	600,000
4. Consultants used for advice on the acquisition of the plant	700,000
5. Interest charges paid to supplier of plant for deferred credit	200,000
6. Estimated dismantling costs to be incurred after 7 years	300,000
7. Operating losses before commercial production	400,000

**Required**

Please advise Extravagant Inc. on the costs that can be capitalized in accordance with IAS 16.

**Q-2**

Mind Changing Inc. owns an asset with an original cost of \$200,000. On acquisition, management determined that the useful life was 10 years and the residual value would be \$20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value. At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to \$10,000.

**Required: Calculate revised depreciation as per above information.**

**IAS -16 SOLUTION**

**Q-1** According to IAS 16, these costs can be capitalized:

	\$
Cost of the plant (cost per supplier's invoice plus taxes)	2,500,000
Initial delivery and handling costs	200,000
Cost of site preparation	600,000
Consultants used for advice on the acquisition of the plant	700,000
Estimated dismantling costs to be incurred after 7 years	300,000
	<b>4,300,000</b>

**NOTES:**

**Interest charges paid to supplier of plant for deferred credit**



Ref Point  
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Interest charges paid on —deferred credit terms to the supplier of the plant (not a qualifying asset) of \$200,000 and thus cannot be capitalized.

**Operating losses before commercial production**



Ref Point  
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Operating losses before commercial production amounting to \$400,000 are not regarded as directly attributable costs and thus cannot be capitalized.

Both of the aforementioned costs shall be written off to the income statement in the period they are incurred.

**Q-2** The asset has a carrying amount of \$56,000 at the end of year 8: \$200,000 (cost) less \$144,000 (accumulated depreciation). Accumulated depreciation is calculated as  
 Depreciable amount equals cost less residual value = \$200,000 – \$20,000 = \$180,000.  
 Annual depreciation = depreciable amount divided by useful life = \$180,000 / 10 = \$18,000.  
 Accumulated depreciation = \$18,000 × no. of years (8) = \$144,000.

Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8). The revised depreciable amount is \$46,000: carrying amount of \$56,000 – the revised residual amount of \$10,000). Thus depreciation should be charged in future at \$11,500 per annum (\$46,000 divided by 4 years).