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Financial Reporting on Property, Plant and Equipment By the Listed Companies in Bangladesh

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Abstract

Financial Reporting of property, plant and equipment is a vital part of presentation of Financial Statements. Presentation of property, plant and equipment is required as per Companies Act 1994 and public limited companies enlisted with stock exchange are to prepare this statement as per other statutory laws and regulations. The acceptance of International Accounting Standard-16: Property, Plant and Equipment, has added a new dimension to the preparation and presentation of financial statement in Bangladesh.. This paper examines empirically the current practices followed by sample companies for the presentation of property, plant and equipment and concludes that sample companies are in line (with few exceptions) with the requirements of International Accounting Standard (IAS-16) or Bangladesh Accounting Standard (BAS-16) and also proposes some suggestions for improving the presentation of the statement.

***Keywords**: Cost Model, Revaluation Model, Depreciation Method, Impairment loss, IAS/BAS.*

Introduction

Property, plant and equipment are tangible resources that are used in the operations of the business and are not intended for sale to customers. They are also called property, plant and equipment or fixed assets (see Weygandt, Kieso & Kimmel: 421). The major characteristics of property, plant and equipment are :(i) they are acquired for use in operations and not for resale ; (ii) they are long-term in nature and usually subject to depreciation; and (iii) they possess physical substance (see Kieso, Weygandt & Warfield; 470).

International Accounting Standards (IAS) 16 on property, plant and equipment (revised 1998) deals with the accounting treatment of property, plant and equipment. IAS 16 (revised 1998) sets out overall consideration for the presentation of property, plant and equipment in the Financial Statements. The recognition, measurement and disclosure related to the property, plant and equipment are dealt with by IAS 16. This paper is an attempt to draw a brief outline of IAS 16, which is mandatory in Bangladesh for Listed Public Limited Companies (PLCs) and also to try to show the empirical extent of financial reporting by listed PLCs in Bangladesh in compliance with IAS 16.The focus is not on the quality of the reporting of the companies but rather on what the reporting levels are in general.

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Objectives of the Study

The objectives of the study are to:

1. Provide an overview of the historical background, objective and scope, and the guidelines for recognition, measurement and determining depreciation method, and for disclosure under IAS 16.
2. Present the enforcement of regulatory framework in Bangladesh for presentation of property, plant and equipment.
3. Articulate the empirical extent of financial reporting on property, plant and equipment by listed Public Limited Companies in Bangladesh in compliance with IAS 16.

Methodology of the Study

The survey has been made covering a total of fourteen annual reports of Public Limited Companies (PLCs) listed with the Stock Exchanges in Bangladesh. The PLCs include three Banks, two Financial Institutions, one Insurance Company and eight other Companies. The annual reports of the ten companies are related to calendar year 2009 and the remainings are related to financial year 2008 (see appendix-A). These are selected on the basis of random sampling. For fulfilling the objectives of the study, some content analyses are done as per requirement of IAS 16. In order to make the study more revealing, it also covers some research articles, textbooks, publications and websites of various accounting bodies.

Limitations of the Study

1. Applied non-profitability techniques have been used.
2. Due to limitation of the extensive materials, books and previous study in Bangladesh, literature review could not be extensive.
3. This study consists of only fourteen Public Limited Companies (PLCs) listed with the Stock Exchanges in Bangladesh due to time and resources constraints.

Literature Review

Historical Background of IAS 16

The International Accounting Standards Committee (IASC) issued Exposure Draft E18, the Presentation of Financial Statements in August 1980, and International Accounting Standard 16 (revised 1998), Presentation of Financial Statements was approved by the IASC. IAS 16 (revised 1668) supersedes SIC 6 Costs of Modifying Existing Software. SIC 6 was superseded by and incorporated into IAS 16 (2003), SIC 14 Property, Plant and Equipment – Compensation for the Impairment or Loss of Items. SIC 14 was superseded by and incorporated into IAS 16 (2003), SIC 23 Property, Plant and Equipment – Major Inspection or Overhaul Costs; SIC 23 was superseded by and incorporated into IAS 16 (2003). Thus, in brief the history of IAS 16 can be presented in the following way:

	HISTORY OF IAS 16(PROPERTY, PLANT AND EQUIPMENT)
August 1980	Exposure Draft E18 *Accounting for Property, Plant and Equipment in the Context of the Historical Cost System*
March 1982	IAS 16 *Accounting for Property, Plant and Equipment*
1 January 1983	Effective date of IAS 16 (1982)
May 1992	Exposure Draft E43 *Property, Plant and Equipment*
December 1993	IAS 16 *Accounting for Property, Plant and Equipment* (revised as part of the 'Comparability of Financial Statements' project)
1 January 1995	Effective date of IAS 16 (1993) *Property, Plant and Equipment*
1998	IAS 16 was revised by IAS 36 *Impairment of Assets*
1 July 1999	IAS 16 (1998) effective date of 1998 revisions to IAS 16
18 December 2003	Revised version of IAS 16 issued by the IASB
1 January 2005	Effective date of IAS 16 (Revised 2003)
22 May 2008	IAS 16 amended for 'Annual Improvements to IFRSs 2007 about routine sales of assets held for rental
1 January 2009	Effective date of May 2008 amendment to IAS 16

Objectives and Scope of IAS 16

The objective of IAS 16 is to prescribe the accounting treatment of property, plant and equipment so that the users of the Financial Statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting of property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them (para-1). Applicability of IAS 16 (revised 1998) can be enumerated as follows:

1. IAS 16 does not apply to:
   i. Property, plant and equipment classified as held for sale and which is discontinued for operations (para-3),
   ii. Biological assets related to agricultural activity (para-3),
   iii. The recognition and measurement of exploration and evaluation assets (para-3), and
   iv. Mineral rights and mineral reserve such as oil, natural gas and similar non-regenerative resources (para-3).
2. IAS 16 applies to property, plant and equipment used to develop or maintain the assets related to biological assets of agricultural activity and also related to mineral rights and mineral reserves.
3. IAS 16 is applicable for other accounting treatment including depreciation of leased property, plant and equipment which is recognized by IAS 17 (para-4).
4. IAS 16 applies to an entity that is being constructed or developed for future use as investment property but does not yet satisfy the definition of investment property in IAS 40 (para-5).
5. An entity using the cost model for investment property in accordance with IAS 40 shall use the cost model in accordance with IAS 16.

Guidelines for the presentations of property, plant and equipment in the Financial Statements under IAS 16

Recognition of property, Plant and Equipment under IAS 16

Each item of property, plant and equipment will be recognized in its cost as assets if and only if: a) it is probable that the future economic benefits associated with the item will flow to the entity; and b) the cost of the item can be measured reliably (para-7).For recognition as an asset shall be measured at its cost. The cost of an item of property, plant and equipment comprises the following:

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 indented 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 purpose other than to produce inventories during that period (para-16).

Except those, the following costs are not costs of an item of property, plant and equipment:

a. Costs of opening a new facility.
b. Costs of introducing a new product or service (including costs of advertising and promotional activities).
c. Cost of conducting business in a new location or with a new class of customer (including costs of staff training).
d. Administrative and other general overhead costs.

Measurement after Recognition

IAS 16 permits two accounting models:

- **Cost Model:** The asset is carried at cost less accumulated depreciation and impairment loss. (para-30)
- **Revaluation Model:** The asset is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably (para-31).

Depreciation of Property, Plant and Equipment

IAS 16 requires that property, plant and equipment are chargeable to depreciation. For all depreciable assets, the depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life (para-50). The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS 8 (para-51). The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity (para-60). The depreciation method should be reviewed at least annually and, if the pattern of consumption of benefits has changed, the depreciation method should be changed prospectively as a change in estimate under IAS 8 (para-61). Depreciation should be charged to the income statement, unless it is included in the carrying

amount of another asset (para-48). Depreciation begins when the asset is available for use and continues until the asset is derecognized, even if it is idle (para-55).

Recoverability of the Carrying Amount

IAS 36 requires impairment testing and, if necessary, recognition of property, plant, and equipment. An item of property, plant, or equipment shall not be carried at more than recoverable amount. Recoverable amount is higher than an asset's fair value less costs to sell and its value in use. Any claim for compensation from third parties for impairment is included in profit or loss when the claim becomes receivable (para-65).

Derecognition under IAS 16 (revised 1998)

The carrying amount of an item of property, plant and equipment should be recognized: (a) on disposals; or (b) when no future economic benefits are expected from its use or disposal (para-67). When the item is derecognized, the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in profit and loss. This gain shall not be classified as revenue (para-68). The gain or loss arising from derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Disclosure under IAS 16

For each class of property, plant, and equipment disclose: (para-73)

- basis for measuring carrying amount
- depreciation method(s) used
- useful lives or depreciation rates
- gross carrying amount and accumulated depreciation and impairment losses
- reconciliation of the carrying amount at the beginning and the end of the period, showing:
    - additions
    - disposals
    - acquisitions through business combinations
    - revaluation increases or decreases
    - impairment losses
    - reversals of impairment losses
    - depreciation
    - net foreign exchange differences on translation
    - other movements.

Also disclose: (para-74)

- restrictions on title
- expenditures to construct property, plant, and equipment during the period
- contractual commitments to acquire property, plant, and equipment
- compensation from third parties for items of property, plant, and equipment that were impaired, lost or given up that is included in profit or loss.

If property, plant, and equipment are stated at revalued amounts, certain additional disclosures are required (para-77).

- the effective date of the revaluation
- whether an independent valuer was involved
- the methods and significant assumptions used in estimating fair values
- the extent to which fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques
- for each revalued class of property, the carrying amount that would have been recognized had the assets been carried under the cost model
- the revaluation surplus, including changes during the period and any restrictions on the distribution of the balance to shareholders

Regulatory Framework for Financial Reporting of Property, Plant and Equipment in the context of Bangladesh

The Companies' Act 1994 (Act No.18 of 1994)

According to section No. 183 of the Companies' Act 1994 (which came into effect from 1 January 1995), a company is required to present balance sheet, profit and loss account (Income and expenditure account, in case of non profit companies). Under section 185, the balance sheet and income statement have to be prepared according to the forms set out in Part –1 and Part –2 of Schedule XI respectively under which information of consecutive two years (concerned year and preceding year) is to be provided. The balance sheet of a company shall be either in horizontal form or is vertical form. In horizontal Form assets are shown in different classification like fixed assets, investment, current assets etc. Here fixed assets include land, building, plant and machinery, furniture and fittings, development of property, vehicles etc. Under each head of fixed assets, the original cost and the additions thereto and the deductions therefrom during the year and the total depreciation written off or provided up to the end of the year are to be stated. However, specific guidelines are prescribed in the Companies' Act 1994.

The Securities and Exchange Rules 1987 (S.R.O. No. 237-L/87 dated 28 September 1987)

Under the provision of rule 12 (1) of the Securities and Exchanges Rules (SER) 1987(amended by the section notification No. SEC/ Section 7/SER/03/132 dated 22 october1997 published in the official gazette on 29 December 1997), the annual report to be furnished by an issuer of listed security shall include "a balance sheet, profit and loss account, cash flow statement and notes to the accounts collectively hereinafter referred to as the financial statement''. Under rule 12(2), the fixed assets shall be distinguished between tangible and intangible and shall be classified under appropriate sub-heads, duly itemized as (i) tangible – land building plant & machinery, furniture & fittings vehicles etc. and (ii) Intangible – Goodwill, patents, copyright, trademarks and design and others. Under each subhead, the original cost and the additions thereto and the deductions therefrom since the date of previous balance sheet, shall be stated and the aggregate amount written off up to the date of balance sheet, by way of provision for depreciation as deduction therefrom.

Empirical Findings of the Study

From the preceding discussion, it is found that there are various diversities of rules to some extent with respect to financial reporting and hence the accounting treatment of property, plant and equipment on financial statements. For the listed public limited companies, the Companies' Act 1994 and the Securities and Exchange Rules 1987 are the dominant provisions. Accordingly, to know about the practice on financial reporting by the enterprises in Bangladesh, a limited survey has been conducted covering a sample of 14 Public Limited Companies (PLCs) enlisted with the Stock Exchange (see Appendix-A). The samples include three banks, two financing companies, one insurance company and eight other manufacturing or distribution or service providing companies. The years covered are calendar year 2009 (seven companies), calendar year 2008 (five companies) and financial year 2007-2008 (two companies) (see Appendix-A).
Under IAS 16 (revised 1998), 100 percent companies in their annual report show property, plant and equipment in the balance sheet and the depreciation expenses are shown in the income statement.

Table-1: Recognition of property, plant and equipment

	Recognition at cost	Total Number of sample companies
Number of sample companies	14	14
Percentage of total sample companies	100%	100%

100 percent of the sample companies recognized their property, plant and equipment at costs and this cost includes the purchase price and any directly attributable costs of bringing the assets to its working condition for its intended use inclusive of inward freight, duties and non-refundable taxes. After recognition, the property, plant and equipment are measured at Cost Model or Revaluation Model under paragraph 29.

Table-2: The measurement of the property, plant and equipment

	Cost Model	Revaluation Model
Number of companies	10	4
Percentage of total sample companies	71%	29%

Here, 4 companies (Islami Bank Ltd., Shinepukur Ceramics Ltd, Pran Agricultural Marketing Co. and Summit Power Ltd.) use Revaluation Model that is 4/14 = 29% and other 10 companies (GlaxoSmithKline Bd. Co. Ltd., Southeast Bank Ltd., Mercantile Bank Ltd., MIDAS Financing Ltd., Islamic Finance and Investment Ltd., Fareast Islamic Life Ltd., Saiham Textile Ltd., Information Service Network Ltd., Meghna Mills Ltd., and Olympic Industries Ltd.). i.e. 71% of the sample companies use Cost Model for measurement.
For allocating depreciation, the PLCs of Bangladesh use two methods which are as follows in Table -3:

Table-3: Depreciation Method used by PLCs of Bangladesh

	Straight–line method(SM)	Diminishing/Reducing balance method (RBM)	Both SM and RBM
No. of companies	4	7	3
Percentage of total sample companies	29%	50%	21%

For determining depreciation, 7 companies (50%) use Reducing/diminishing balance method and 4 companies (29%) use straight line method and 3 companies (21%) use reducing balance method for all assets except motor car, computer and vehicles for which the companies use straight line method.

Table-4: Summary of total assets, Investment in Property, Plant and Equipment (PP&E) and percentage of depreciation of all sample companies.

Name of the companies	*Total assets (in '000)*	*Amount of PP&E (Tk. in '000)*	*% of PP&E of total assets*	*% of depreciation of PP&E*
Mercantile Bank Ltd.	*66,166,516*	*1,261,875*	*1.9%*	*6.3%*
Southeast Bnk Ltd.	*112,676,985*	*4,671,285*	*4.15%*	*1.95%*
Islami Bank Bangladesh Ltd.	*230,879,135*	*5,421,712*	*2.35%*	*3.86%*
MIDAS Financing Ltd.	*2,647,026*	*113,297*	*4.28%*	*1.4%*
Inlamic Finance and Investment Ltd.	*3,525,267*	*40,587*	*1.5%*	*11%*
Summit Power Ltd.	*10,121,064*	*9,554,812*	*95%*	*2.29%*
GlaxoSmithKline Bangladesh Ltd	*1,701,502*	*796,776*	*46%*	*6.5%*
Olympic Industries Ltd.	*996,283*	*737668*	*74%*	*6.5%*
Meghna Cement Mills Ltd.	*2,916,600*	*1,885,710*	*65%*	*4.5%*
Shinepukur Ceramics Ltd.	*4,449,211*	*2,926,100*	*66%*	*3.9%*
Information Services Network Ltd.	*105,751*	*98,724*	*93%*	*6.65%*
Fareast Islami Life Insurance Co. Ltd.	*6,451,323*	*582,243*	*8.19%*	*3.93%*
Pran Agricultural Marketing Ltd	*923,187*	*916,759*	*67%*	*5.4%*
Saiham Textile Mills Ltd	*492,553*	*241,690*	*69%*	*7.4%*

From the Table-4, it is found that all types of manufacturing companies have a major portion of their total assets invested in Property, Plant and Equipment, especially Summit Power Ltd Information Services Network Ltd. respectively 95% & 93%. And banking companies, financing companies and insurance companies have a minor investment in Property, Plant and Equipment. For this reason, in case of charging depreciation, manufacturing companies charged more percentage of depreciation than other companies.

Table-5: Disclosure of Property, Plant and Equipment

Name of the Companies	**Recognition of PP&E**	**Measurement after Recognition**	**Depreciation Method Used: SM,RBM/DBM***	**Disclosure**										
				Para-73					**Para-77**					
				A	**B**	**C**	**D**	**E**	**a**	**b**	**c**	**d**	**e**	**f**
Mercantile Bank Ltd.	At cost	Cost Model	RBM&SM	√	√	√	√	√	X	X	X	X	X	X
Southeast Bnk Ltd.	At cost	Cost Model	RBM&SM	√	√	√	√	√	X	X	X	X	X	X
Islami Bank Bangladesh Ltd.	At cost	Revaluation Model	RBM&SM	√	√	√	√	√	√	√	X	X	√	√
MIDAS Financing Ltd.	At cost	Cost Model	RBM	√	√	√	√	√	X	X	X	X	X	X
Inlamic Finance and Investment Ltd.	At cost	Cost Model	RBM	√	√	√	√	√	X	X	X	X	X	X
Summit Power Ltd.	At cost	Revaluation Model	SM	√	√	√	√	√	√	√	X	X	√	√
GlaxoSmithKline Bangladesh Ltd	At cost	Cost Model	SM	√	√	√	√	√	X	X	X	X	X	X
Olympic Industries Ltd.	At cost	Cost Model	SM	√	√	√	√	√	X	X	X	X	X	X
Meghna Cement Mills Ltd.	At cost	Cost Model	RBM	√	√	√	√	√	X	X	X	X	X	X
Shinepukur Ceramics Ltd.	At cost	Revaluation Model	RBM	√	√	√	√	√	√	√	X	X	√	√

Cont. Table

Name of the Companies	Recognition of PP&E	Measurement after Recognition	Depreciation Method Used: SM,RBM/DBM*	Disclosure Para-73					Para-77					
Information Services Network Ltd.	At cost	Cost Model	DBM	√	√	√	√	√	X	X	X	X	X	X
Fareast Islami Life Insurance Co. Ltd.	At cost	Cost Model	DBM	√	√	√	√	√	X	X	X	X	X	X
Pran Agricultural Marketing Ltd	At cost	Revaluation Model	RBM	√	√	√	√	√	√	√	X	X	√	√
Saiham Textile Mills Ltd	At cost	Cost Model	SM	√	√	√	√	√	X	X	X	X	X	X

**Here SM=Straight Line Method, RBM= Reducing Balance Method, and DBM =Diminishing Balance Method*

From Table-5, it is found that each of the companies discloses each class of property, plant and equipment in its Financial Statements and also discloses all information that is required in paragraph 73. Some of the companies like Islami Bank Bangladesh Ltd., Shinepukur Ceramics Ltd., Pran Agricultural Marketing co. and Summit Power Ltd., used revaluation model for measurement after recognition of their property, plant and equipment and they disclose the information that is required in paragraph 77(a),(b), (e),(f).But they did not disclose the methods and significant assumptions applied in estimating the items' fair values and the extend to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques under paragraph 77(c),(d). For impairment loss of assets any of the companies did not provide any statement, only MIDAS Financing Ltd. has given notes on that matter, for example, if any indication of impairment of assets is reviewed, then they charge it as required BAS-36.

Therefore, from the survey it is found that almost all the companies have presented the Financial Statements in their annual reports in compliance with IAS 16 and other concerned regulation. Some of the companies clearly disclose in their notes to Financial Statements that they have followed and complied with Bangladesh Accounting Standard 16. In some cases, full compliance is not found because they did not disclose their full information under paragraph 73-79.

Conclusion

A materially misstatement of presentation of property, plant and equipment, whether it is in terms of incorrect classification in the categories or numerical accuracy, can be misleading to the user and can lead to wrong decisions taken by the users of statements. The survey has revealed that the adoption and implementation of IAS16 is satisfactory and even in most cases, the companies have clearly disclosed that they have complied with BAS16 (i.e.IAS16) that is adopted by ICAB. The Companies' Act 1994 and SEC Rules 1987 provide guidelines for presentation of property, plant and equipment in the financial statement. But in Insurance Act 1938 and Banking Act 1991, there is no specific guideline for presentation of property, plant and equipment. Against violation of provisions of IAS 16, there is no specific law of enforcement in the Companies' Act 1994 and SEC Ordinance 1969.This necessitates that professional body should come forward to establish specific guidelines for the companies.

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Appendix-A

The name and year of the surveyed companies:

SL No.	Name of the Company	Year
01	Mercantile Bank Ltd.	2009
02	Southeast Bank Ltd.	2009
03	MIDAS Financing Ltd.	2009
04	Islami Finance and Investment Ltd.	2009
05	Summit Power Ltd.	2009
06	GlaxoSmithKline Bangladesh Ltd.	2009
07	Olympic Industries Ltd.	2009
08	Islami Bank Bangladesh Ltd.	2008
09	Meghna Cement Mills Ltd.	2008
10	Shinepukur Ceramics Ltd.	2008
11	Information Services Network Ltd.	2008
12	Fareast Islami Life Insurance Co. Ltd.	2008
13	Pran Agricultural Marketing Ltd	2007-08
14	Saiham Textile Mills Ltd.	2007-08