

HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation

5

Property, plant and equipment - Compensation for the impairment or loss of items

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

- References:**
- Framework for the preparation and presentation of financial statements*
 - SSAP 17 Property, plant and equipment*
 - SSAP 28 Provisions, contingent liabilities and contingent assets*
 - SSAP 31 Impairment of assets*

ISSUE

1. Enterprises may receive monetary or non-monetary compensation from third parties for the impairment or loss of items of property, plant and equipment. Often the monetary compensation received has to be used for compelling economic reasons to restore impaired assets or to purchase or construct new assets in order to replace the assets lost or given up. SSAP 17 does not give explicit guidance on how to account for such monetary or non-monetary compensation.
2. Examples of such cases may include :
 - (a) reimbursement by insurance companies after an impairment or loss of items of property, plant and equipment, for example, due to natural disasters, theft or mishandling;
 - (b) indemnities by the government for items of property, plant and equipment that were expropriated, for example, land that has to be used for public purposes;
 - (c) compensation related to the involuntary conversion of items of property, plant and equipment, for example, relocation of facilities from a designated urban area to a non-urban area in accordance with a government land policy; or
 - (d) physical replacement in whole or in part of an impaired or lost asset.
3. The issue is how an enterprise should account for:
 - (a) impairments or losses of items of property, plant and equipment;
 - (b) related compensation from third parties; and
 - (c) subsequent restoration, purchase or construction of assets.

CONCLUSIONS

4. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and should be accounted for as such. The three economic events should be accounted for separately as follows:
 - (a) impairments of items of property, plant and equipment should be recognised under SSAP 31, the retirement or disposal of items of property, plant and equipment should be recognised under SSAP 17;
 - (b) monetary or non-monetary compensation from third parties for items of property, plant and equipment that were impaired, lost or otherwise given up should be included in profit or loss for the period when recognised; and
 - (c) the cost of assets restored, purchased or constructed as a replacement, or received as compensation should be determined and presented in accordance with SSAP 17.

DISCLOSURE

5. Monetary or non-monetary compensation recognised for the impairment or loss of items of property, plant and equipment should be disclosed separately.

BASIS FOR CONCLUSIONS

6. SSAP 31 paragraph 58 requires that an impairment loss be recognised whenever the carrying amount of an asset exceeds its recoverable amount. Compensation to be received from third parties for the restoration of impaired assets is not included in the determination of the recoverable amount of an asset. Such impairment losses and related compensation are accounted for as separate events.
7. SSAP 17 paragraph 67 requires that gains or losses from the retirement or disposal of an item of property, plant and equipment should be recognised as income or expense in the income statement when the item is retired or disposed of.
8. Paragraph 90 of the Framework states: "income is recognised in the profit and loss account when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably". The same rationale applies to compensation receivable from third parties by an enterprise for the restoration or replacement of items of property, plant and equipment that were impaired, lost or otherwise given up in the past.
9. Where the receipt of compensation from third parties is dependant on the occurrence or non-occurrence of one or more future events not wholly within the control of the enterprise, it is a contingent asset as defined in SSAP 28 paragraph 10. Under SSAP 28 paragraph 31, contingent assets are not recognised. SSAP 28 paragraph 33 states that "when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate".
10. In accordance with SSAP 17 paragraph 23, expenditure on the restoration of impaired items of property, plant and equipment is added to the carrying amount of the assets to the extent that it is probable that future economic benefits, in excess of the assessed standard of performance of the existing assets after recognition of impairment losses, will flow to the enterprise. Such expenditure may either be incurred by the reporting enterprise itself or directly by the third party obliged to compensate for the impairment.

11. In accordance with SSAP 17 paragraphs 7 and 15, items of property, plant and equipment acquired or constructed to replace impaired or lost assets are initially recognised at cost.
12. Situations involving government grants and assistance related to assets are not analogous to those dealt with in this Interpretation. As a result, setting up compensation funds received as deferred income or deducting the amounts from the acquisition or construction costs of new assets is not appropriate.

DATE OF ISSUE: 7 September 1999

DATE OF REVISION: 20 March 2001