Advanced PP&E Issues/ Natural Resources/ Intangibles

Part 3

Your goals for this “advanced PP&E issues, natural resources, and intangibles” chapter are to learn about:

- The accounting for costs incurred subsequent to asset acquisition.
- Appropriate methods to measure and record the disposal of property, plant, and equipment.
- Accounting for asset exchanges.
- Rules for recording asset impairments.
- Natural resource accounting and depletion concepts.
- Intangible asset accounting and amortization concepts.

15. PP&E Costs Subsequent to Asset Acquisition

Think about an automobile. The vehicle must be fueled, insured, and maintained. Maintenance will include a variety of items like washing, oil and lube, tires, wiper blades, brake jobs, tune-ups, engine overhaul, body damage repair, and on and on. Cars are not unique; most items of PP&E will require substantial ongoing costs to keep them in good order. The accounting rules for such costs are to treat them as "capital expenditures" (i.e., put them on the balance sheet as an asset of some type) if future economic benefits result from the expenditure. Future economic benefits occur if the service life of an asset is prolonged, the quantity of services expected from an asset are increased, or the quality of services expected from an asset are improved. Expenditures not meeting at least one of these criteria should be accounted for as a "revenue expenditure" and be expensed as incurred. Judgment is again required in applying these rules.

A literal reading of those rules might lead you to believe that routine maintenance would be capitalized. After all, putting fuel in a car does "extend its service life;" without fuel its service life would end. But that interpretation would be a misconstruing of the intent of the rule. Specifically, it is intended that ongoing costs necessary to maintain the normal operating condition are expensed as incurred. These costs are simply referred to as normal "repair and maintenance" expenditures

15.1 Restoration and Improvement

A delivery truck may have a perfectly good frame, but the engine has many miles of use and is in need of replacement. In essence, the replacing of the engine represents a "restoration" of some of the original condition (akin to "undepreciating" a portion of the truck). Restoration and improvement type costs are considered to meet the conditions for capitalization. The journal entry to reflect this restoration is:

5-15-X5	Accumulated Depreciation		16,000	
	Cash			16,000
	Paid $16,000 to replace the engine on delivery truck			

Notice that the above debit is to Accumulated Deprecation. The effect is to increase the net book value of the asset by reducing its accumulated depreciation on the balance sheet. This approach is perfectly fine for "restoration" expenditures. However, if you are "improving" the asset beyond its original condition (sometimes termed a "betterment"), such costs would be capitalized by debiting the asset account, as follows:

5-15-X5	Equipment		16,000	
	Cash			16,000
	Paid $16,000 to add refrigeration equipment not previously installed on the truck			