

Quarry is an Inventory or PPE?

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Introduction

PQR Construction (Private) Limited (“Company”) is a limited liability company incorporated and domiciled in Sri Lanka. During the year, the principal activities of the Company were undertaking construction contracts. Mainly they construct the roads & water projects.

Year ended 31/03/2015 PQR LTD purchased a land which includes Quarry and that Quarry has been recognized as an inventory in their accounts. But according to the LKAS 16 (Property, Plant & Equipment) it should be recognized as a Property, Plant & Equipment.

Discussion of the Issue

This issue is related to the recognition of “Quarry”. During the year client purchased a land which includes a Quarry. Main intention of purchasing of this land is to acquire the Quarry. This quarry is of 1,500,000 cubic meters. Client value this Quarry separately using professional valuer & the value of cubic meter is Rs.100. Client has recognized it as an inventory in their Financial Statements. But according to the LKAS 16 (Property, Plant & Equipment) it should be recognized as a PPE.

Implication of the Issue

Income Statement

Due to this, this year closing stock balance of the company has been overstated. But apart from this since this has not been recognized as PPE in this year, depreciation amount has been understated resulting an overstatement of the profit.

Statement of Financial Position

PPE face value of the balance sheet has been understated; also face value of the Inventory has been overstated.

Conclusion & Recommendation

According to the standard this Quarry satisfies the following criteria which are provided by LKAS 16.

Justification for that Quarry is recognized as “PPE”?

As per LKAS 16	Justification
Tangible asset ; Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; Paragraph 6)	"Quarry" can be tangible This Quarry, use in their production process in order to develop the roads.
Expected to be used during more than one period (Paragraph 6)	This Quarry used over 30 years Because they normally consumed 30,000 cubic Meters for the year.
It is probable that future economic benefits associated with the item will flow to the entity (Paragraph 7)	Definitely through their outputs it is highly probable that future economic benefits Flow to the Entity.
The cost of the item can be measured reliably (Paragraph 7)	This Quarry contains 1,500,000 cubic meters. The market price of one cubic meter of this quarry is about LKR 100. Since that the cost of 1,500,000 cubic meters of Quarry is (1,500,000*100) LKR 150,000,000 (LKR 150 mil).

Therefore as per above extractions and justifications (all satisfied) from the standard (LKAS 16). Therefore this Quarry should be recognized as PPE (Property, Plant and Equipment) & blasted part should be recognized as an inventory.

Accounting Adjustment:

Reversed the stock

PPE A/c (Dr)	**	
		Inventory A/c (Cr) **

Depreciation Charge for the year

The Company has made a significant judgment on the useful life of the quarry. Based on the estimation given by the engineers employed by the Company, it has estimated the quarry to yield a total of 1.5 mn Cubes of stones used in construction. As such, the Company charges to the profit and loss the cost of stones mined from the quarry based on the costing formula as below;

Cost per Cube = Total Cost of Quarry / Estimated number of Cubes to be mined from quarry

The Company's policy is to reassess this estimate every year. Any changes in estimates will be adjusted prospectively, and do not require a retrospective adjustment.

1) Profit and Loss A/c (Dr)	**	
		Provision for depreciation A/c (Cr) **

(During the year charge for the depreciation, charged to the P & L acc.)