Chapter 10 – Property, plant and equipment

The following are extracts relating to property, plant and equipment from the 2015 financial statements of Marston's plc, an independent brewing and pub retailing business listed in the UK.

Required:
Comment on the information provided in the context of international financial reporting standards relating to property, plant and equipment. Discuss how this information will be used by an equity investor in their interpretation of the financial statements.

Group Income Statement
For the 52 weeks ended 3 October 2015

		2015			2014		
	Note	**Underlying items £m**	**Non-underlying items £m**	**Total £m**	Underlying items £m	Non-underlying items £m	Total £m
Revenue	2, 3, 4	**845.5**	**33.1**	**878.6**	787.6	27.7	845.3
Operating expenses*	3	**(680.1)**	**(84.7)**	**(764.8)**	(631.5)	(134.7)	(766.2)
Operating profit	2, 4	**165.4**	**(51.6)**	**113.8**	156.1	(107.0)	49.1
Finance costs	6	**(74.5)**	**—**	**(74.5)**	(73.4)	(27.0)	(100.4)
Finance income	6	**0.6**	**—**	**0.6**	0.3	—	0.3
Movement in fair value of interest rate swaps	4, 6	**—**	**(8.6)**	**(8.6)**	—	(8.2)	(8.2)
Net finance costs	4, 6	**(73.9)**	**(8.6)**	**(82.5)**	(73.1)	(35.2)	(108.3)
Profit/(loss) before taxation		**91.5**	**(60.2)**	**31.3**	83.0	(142.2)	(59.2)
Taxation	4, 7	**(17.7)**	**9.7**	**(8.0)**	(16.3)	24.8	8.5
Profit/(loss) for the period attributable to equity shareholders		**73.8**	**(50.5)**	**23.3**	66.7	(117.4)	(50.7)
Earnings/(loss) per share:							
Basic earnings/(loss) per share	9			**4.1p**			(8.9)p
Basic underlying earnings per share	9			**12.9p**			11.7p
Diluted earnings/(loss) per share	9			**4.0p**			(8.9)p
Diluted underlying earnings per share	9			**12.8p**			11.6p

Group Statement of Comprehensive Income
For the 52 weeks ended 3 October 2015

	2015	2014
	£m	£m
Profit/(loss) for the period	**23.3**	(50.7)
Items of other comprehensive income that may subsequently be reclassified to profit or loss		
Losses arising on cash flow hedges	**(56.1)**	(36.4)
Transfers to the income statement on cash flow hedges	**12.2**	39.0
Tax on items that may subsequently be reclassified to profit or loss	**8.7**	(0.5)
	(35.2)	2.1
Items of other comprehensive income that will not be reclassified to profit or loss		
Remeasurement of retirement benefits	**(6.7)**	(12.5)
Unrealised surplus on revaluation of properties*	**216.5**	16.4
Reversal of past revaluation surplus*	**(120.6)**	(3.4)
Tax on items that will not be reclassified to profit or loss	**(17.1)**	0.8
	72.1	1.3
Other comprehensive income for the period	**36.9**	3.4
Total comprehensive income/(expense) for the period	**60.2**	(47.3)

* During the current period revaluations of the Group's freehold and leasehold properties were undertaken, resulting in a net increase in property values of £57.3 million. An unrealised surplus on revaluation of £216.5 million and a reversal of past revaluation surplus of £120.6 million have been recognised in the revaluation reserve, and a net charge of £38.6 million has been recognised in the income statement. Further detail is provided in notes 4, 11, 12 and 15 to the financial statements.

Group Balance Sheet
As at 3 October 2015

	Note	**3 October 2015 £m**	4 October 2014 £m
Non-current assets			
Goodwill	10	**227.5**	224.2
Other intangible assets	11	**37.6**	25.1
Property, plant and equipment	12	**2,122.6**	1,990.0
Deferred tax assets	22	**67.8**	49.1
Retirement benefit surplus	25	**15.0**	7.8
Other non-current assets	13	**12.1**	11.5
		2,482.6	2,307.7
Current assets			
Inventories	14	**28.2**	23.0
Trade and other receivables	16	**84.3**	72.9
Cash and cash equivalents	30	**193.1**	180.9
		305.6	276.8
Assets held for sale	15	**18.0**	38.3
Current liabilities			
Borrowings	17	**(154.0)**	(151.6)
Derivative financial instruments	18	**(25.7)**	(19.5)
Trade and other payables	21	**(185.2)**	(157.0)
Current tax liabilities		**(7.2)**	(14.2)
		(372.1)	(342.3)
Non-current liabilities			
Borrowings	17	**(1,284.1)**	(1,227.5)
Derivative financial instruments	18	**(167.0)**	(120.7)
Deferred tax liabilities	22	**(156.8)**	(131.3)
Other non-current liabilities	23	**(1.8)**	(2.9)
Provisions for other liabilities and charges	24	**(41.5)**	(39.1)
		(1,651.2)	(1,521.5)
Net assets		**782.9**	759.0
Shareholders' equity			
Equity share capital	27	**44.4**	44.4
Share premium account		**334.0**	334.0
Revaluation reserve		**616.0**	545.9
Capital redemption reserve	28	**6.8**	6.8
Hedging reserve		**(128.1)**	(92.9)
Own shares	28	**(118.7)**	(126.8)
Retained earnings		**28.5**	47.6
Total equity		**782.9**	759.0

Extract from: Group Statement of Changes in Equity
For the 52 weeks ended 3 October 2015

	Revaluation reserve	
	2015	2014
	£m	£m
At 5 October 2014	**545.9**	575.3
Property revaluation	**216.5**	16.4
Property impairment	**(120.6)**	(3.4)
Deferred tax on properties	**(18.5)**	(2.0)
Total comprehensive income	**77.4**	11.0
Disposal of properties	**(7.4)**	(44.6)
Tax on disposal of properties	**0.9**	4.7
Transfer to retained earnings	**(0.8)**	(0.5)
Total transactions with owners	**(7.3)**	(40.4)
At 3 October 2015	**616.0**	545.9

Extract from: Performance and financial review

Non-underlying items

There is a net non-underlying charge of £50.5 million after tax. This primarily reflects the external estate valuation undertaken in the period, which resulted in a £39.0 million charge to the income statement. A net revaluation increase of £95.9 million has also been recognised in the revaluation reserve in respect of property revaluations undertaken in the period.

Accounting Policies

Property, plant and equipment

- Freehold and leasehold properties are initially stated at cost and subsequently at valuation. Plant and machinery and fixtures, fittings, tools and equipment are stated at cost.
- Depreciation is charged to the income statement on a straight-line basis to provide for the cost of the assets less residual value over their useful lives.
- Freehold and long leasehold buildings are depreciated to their residual value over 50 years.
- Short leasehold properties are depreciated over the life of the lease.
- Plant and machinery and fixtures, fittings, tools and equipment are depreciated over periods ranging from 3 to 15 years.
- Own labour and interest costs directly attributable to capital projects are capitalised.
- Land is not depreciated.

Residual values and useful lives are reviewed and adjusted if appropriate at each balance sheet date.

Properties are revalued by qualified valuers on a sufficiently regular basis using open market value so that the carrying value of an asset does not differ significantly from its fair value at the balance sheet date. Substantially all of the Group's properties have been externally valued in accordance with the Royal Institution of Chartered Surveyors' Red Book. These valuations are performed directly by reference to observable prices in an active market or recent market transactions on arm's length terms. Internal valuations are performed on the same basis.

The estate is reviewed for indication of impairment at each reporting date, using a process focusing on areas of risk and business performance throughout the portfolio to identify any exposure.

Impairment losses are charged to the revaluation reserve to the extent that a previous gain has been recorded, and thereafter to the income statement. Surpluses on revaluation are recognised in the revaluation reserve, except to the extent that they reverse previously charged impairment losses, in which case the reversal is recorded in the income statement.

Disposals of property, plant and equipment
Profit/loss on disposal of property, plant and equipment represents net sale proceeds less the carrying value of the assets. Any element of the revaluation reserve relating to the property disposed of is transferred to retained earnings at the date of sale.

Impairment
If there are indications of impairment or reversal of impairment, an assessment is made of the recoverable amount. An impairment loss is recognised where the recoverable amount is lower than the carrying value of assets, including goodwill. The recoverable amount is the higher of value in use and fair value less costs to sell.

Where there is an indication that any previously recognised impairment losses no longer exist or have decreased, a reversal of the loss is made if there has been a change in the estimates used to determine the recoverable amounts since the last impairment loss was recognised. The carrying amount of the asset is increased to its recoverable amount only up to the carrying amount that would have resulted, net of depreciation or amortisation, had no impairment loss been recognised for the asset in prior periods. The reversal is recognised in the income statement unless the asset is carried at revalued amount. The reversal of an impairment loss on a revalued asset is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in the income statement, the reversal of that impairment loss is recognised in the income statement. The depreciation charge is adjusted in future periods to allocate the asset's revised carrying value, less any residual value, on a systematic basis over its remaining useful life. There is no reversal of impairment losses relating to goodwill.

Acquired brands are reviewed for impairment on a portfolio basis.

Assets held for sale
Assets, typically properties and related fixtures and fittings, are categorised as held for sale when the value of the asset will be recovered through a sale transaction rather than continuing use. This condition is met when the sale is highly probable, the asset is available for immediate sale in its present condition and is being actively marketed. In addition, the Group must be committed to the sale and completion should be expected to occur within one year from the date of

classification. Assets held for sale are valued at the lower of carrying value and fair value less costs to sell, and are no longer depreciated.

Key assumptions and significant judgements
IFRS requires the Group to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The Group's key assumptions and significant judgements are in respect of property, plant and equipment, taxation, impairment, retirement benefits, financial instruments, property lease provisions, share-based payments and non-underlying items. Details of these assumptions and judgements are provided in the relevant accounting policy and detailed note to the financial statements as set out below:

Property, plant and equipment
- Valuation of properties (see accounting policy).
- Assets' useful lives and residual values (see accounting policy).

Extract from: Auditors' Report

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as 'areas of focus' in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of Focus
Valuation of the estate (notes 1, 4, 11, 12 and 15)
We focused on the Directors' annual assessment of the carrying value of land and buildings because properties are a significant item on the balance sheet. The valuation in the period resulted in a net increase in shareholders' equity of £57.3 million and a net £38.6 million impairment charge in the income statement. There are complex and subjective assumptions used in the valuations, including the future expected performance of pubs and multiples to be applied.

How the auditors assessed the area of focus
We obtained the Directors' valuation and impairment analysis and discussed the valuations, the methodology adopted and the assumptions used with the Group's estates team and our valuation specialists. We also took into account the impact of changes in macroeconomic conditions, pub performance and recent market transactions and their associated multiples. We assessed the valuation methodologies adopted and found them to be appropriate.
We verified management's assumptions on future earnings and multiples using recent market transactions data, historical pub performance and the level of investment in properties and

considered the impact of movements in key assumptions. We found the assumptions adopted to be appropriate and consistent with our knowledge of the business.
Where material adjustments to valuations of specific assets occurred we agreed the revaluation adopted by management to external market information or third party evidence, including offers received that supported the value.
We found that the estate had been valued in line with the Group's policy using appropriate methodologies and assumptions.

Note 4. Non-underlying items

	2015	2014
	£m	£m
Exceptional operating items		
Non-core estate disposal and reorganisation costs	**2.5**	50.6
Impairment of freehold and leasehold properties	**39.0**	-
Impact of change in rate assumptions used for onerous lease provisions	**4.9**	-
Relocation, reorganisation and integration costs	**2.6**	-
Loss on portfolio disposal of pubs	**-**	35.8
Recognition of onerous lease provisions and associated leasehold impairments	**-**	29.5
Credit in respect of defined benefit pension plan	**-**	(10.8)
	49.0	105.1
Other adjusting operating items		
Results in respect of the ongoing management of pubs in the portfolio disposal	**2.6**	1.9
	2.6	1.9
Non-underlying operating items	**51.6**	107.0
Exceptional non-operating items		
Interest on Rank refunds	**-**	(0.2)
Buyback of securitised debt and associated costs	**-**	27.2
Movement in fair value of interest rate swaps	**8.6**	8.2
	8.6	35.2
Total non-underlying items	**60.2**	142.2

Non-core estate disposal and reorganisation costs

During the period ended 5 October 2013 the Group restructured both its pub estate and its operating segments. Costs in respect of this restructuring were incurred in both the current and prior period. The prior period exceptional charge of £50.6 million included an amount of £29.6 million in respect of the impairment of non-core properties.

Impairment of freehold and leasehold properties

At 1 February 2015 the Group's freehold and leasehold properties were revalued by independent chartered surveyors on an open market value basis. The resulting revaluation adjustments have been recognised in the revaluation reserve or income statement as appropriate. The amount recognised in the income statement comprises:

	2015
	£m
Impairment of other intangible assets (note 11)	**0.1**
Reversal of impairment of other intangible assets (note 11)	**(0.2)**
Impairment of property, plant and equipment (note 12)	**60.1**
Reversal of impairment of property, plant and equipment (note 12)	**(26.3)**
Impairment of assets held for sale (note 15)	**5.0**
Reversal of impairment of assets held for sale (note 15)	**(0.1)**
Valuation fees	**0.4**
	39.0

Note 12. Property, plant and equipment

	Land and buildings	Plant and machinery	Fixtures, fittings, tools and equipment	Total
	£m	£m	£m	£m
Cost or valuation				
At 5 October 2014	1,826.9	53.7	293.3	2,173.9
Additions	102.4	6.1	35.1	143.6
Acquisitions	2.0	2.0	2.1	6.1
Net transfers to assets held for sale and disposals	(41.2)	(1.8)	(28.5)	(71.5)
Revaluation	58.4	-	-	58.4
At 3 October 2015	**1,948.5**	**60.0**	**302.0**	**2,310.5**
Depreciation				
At 5 October 2014	3.7	24.3	155.9	183.9
Charge for the period	2.2	4.7	29.4	36.3
Net transfers to assets held for sale and disposals	-	(1.8)	(26.8)	(28.6)
Revaluation/impairment	(4.4)	-	0.7	(3.7)
At 3 October 2015	**1.5**	**27.2**	**159.2**	**187.9**
Net book amount at 4 October 2014	1,823.2	29.4	137.4	1,990.0
Net book amount at 3 October 2015	**1,947.0**	**32.8**	**142.8**	**2,122.6**
Cost or valuation				
At 6 October 2013	1,889.6	49.4	310.5	2,249.5
Additions	107.5	6.8	29.2	143.5
Net transfers to assets held for sale and disposals	(176.4)	(2.5)	(46.4)	(225.3)
Revaluation	6.2	-	-	6.2
At 4 October 2014	**1,826.9**	**53.7**	**293.3**	**2,173.9**

Depreciation				
At 6 October 2013	1.9	22.7	161.3	185.9
Charge for the period	2.0	4.1	29.0	35.1
Net transfers to assets held for sale and disposals	-	(2.5)	(35.2)	(37.7)
Revaluation	(0.2)	-	0.8	0.6
At 4 October 2014	**3.7**	**24.3**	**155.9**	**183.9**
Net book amount at 5 October 2013	1,887.7	26.7	149.2	2,063.6
Net book amount at 4 October 2014	**1,823.2**	**29.4**	**137.4**	**1,990.0**

The net book amount of land and buildings is split as follows:

	2015	2014
	£m	£m
Freehold properties	**1,662.1**	1,578.3
Leasehold properties over 50 years unexpired	**237.8**	215.5
Leasehold properties under 50 years unexpired	**47.1**	29.4
	1,947.0	1,823.2

Cost or valuation of land and buildings comprises:

	2015	2014
	£m	£m
Valuation	**1,902.9**	1,647.2
At cost	**45.6**	179.7
	1,948.5	1,826.9

If the freehold and leasehold properties had not been revalued, the historical cost net book amount would be £1,450.6 million (2014: £1,325.9 million).

Cost at 3 October 2015 includes £25.4 million (2014: £25.8 million) of assets in the course of construction.

Interest costs of £1.3 million (2014: £1.5 million) were capitalised in respect of the financing of major projects.

The net profit on disposal of property, plant and equipment, intangible assets and assets held for sale was £9.2 million (2014: loss of £46.5 million). A profit on disposal of £10.6 million (2014: £8.1 million) is included within the Group's underlying results.

Capital expenditure authorised and committed at the period end but not provided for in the financial statements was £11.4 million (2014: £9.0 million).

The net book amount of land and buildings held under finance leases at 3 October 2015 was £28.0 million (2014: £21.8 million). The net book amount of land and buildings held as part of sale and leaseback arrangements that do not fall within the scope of IAS 17 'Leases' was £251.1 million (2014: £161.2 million).

Revaluation/impairment

At 1 February 2015 independent chartered surveyors revalued the Group's freehold and leasehold properties on an open market value basis. These valuations have been incorporated into the financial statements and the resulting revaluation adjustments have been recognised in the revaluation reserve or income statement as appropriate.

During the current and prior period various properties were reviewed for impairment and/or material changes in value. These valuation adjustments were recognised in the revaluation reserve or the income statement as appropriate.

The impact of the revaluations/impairments described above is as follows:

	2015	2014
	£m	£m
Income statement:		
Revaluation loss charged as an impairment	**(60.1)**	(7.4)
Reversal of past impairment	**26.3**	-
	(33.8)	(7.4)
Revaluation reserve:		
Unrealised revaluation surplus	**216.5**	16.4
Reversal of past revaluation surplus	**(120.6)**	(3.4)
	95.9	13.0
Net increase in shareholders' equity /property, plant and equipment	**62.1**	5.6

Fair value of land and buildings

IFRS 13 'Fair Value Measurement' requires fair value measurements to be recognised using a fair value hierarchy that reflects the significance of the inputs used in the measurements, according to the following levels:

Level 1 – unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3 – inputs for the asset or liability that are not based on observable market data.

The table below shows the level in the fair value hierarchy into which the fair value measurements of land and buildings have been categorised:

Recurring fair value measurements

	2015				2014			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Land and buildings:								
Specialised brewery properties	**–**	**–**	**25.0**	**25.0**	–	–	23.7	23.7
Other land and buildings	**–**	**1,922.0**	**–**	**1,922.0**	–	1,799.5	–	1,799.5
	–	**1,922.0**	**25.0**	**1,947.0**	–	1,799.5	23.7	1,823.2

There were no transfers between Levels 1, 2 and 3 fair value measurements during the current or prior period.

The Level 2 fair values of land and buildings have been obtained using a market approach, primarily using earnings multiples derived from prices in observed transactions involving comparable businesses.

The Level 3 fair values of the specialised brewery properties have been obtained using a cost approach. These breweries represent properties that are rarely, if ever, sold in the market, except by way of a sale of the business of which they are part, due to the uniqueness arising from their specialised nature, design and configuration. As such the valuation of these properties has been performed using the depreciated replacement cost approach, which values the properties at the current cost of replacing them with their modern equivalents less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

The significant unobservable inputs to the Level 3 fair value measurements are:

	Sensitivity of fair value to unobservable inputs
Current cost of modern equivalent asset	The higher the cost the higher the fair value
Amount of adjustment for physical deterioration/obsolescence	The higher the adjustment the lower the fair value

Level 3 recurring fair value measurements	**2015** **£m**	2014 £m
At the beginning of the period	**23.7**	23.7
Additions	**0.4**	0.3
Revaluation	**1.2**	-
Depreciation charge for the period	**(0.3)**	(0.3)
	25.0	23.7

The Group's properties are revalued by external independent qualified valuers at least once in each rolling three year period. The last external valuation of the Group's freehold and leasehold properties was performed as at 1 February 2015. The Group has an internal team of qualified valuers and at each reporting date the estate is reviewed for any indication of significant changes in value. Where this is the case internal valuations are performed on a basis consistent with those performed externally.

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