

## 10.6 Interpreting Disclosures for Property, Plant, and Equipment

Petrobras, which operates in the energy sector, is Brazil's largest company. Its shares trade on several of the world's leading stock exchanges. A portion of Petrobras' balance sheet, its income statement, and extracts from a note on PP&E are presented in Exhibit 10.1.

### Required

Based on the information provided, answer the following questions:

- a. What portion of Petrobras' "Equipment and other assets" had been "used up" by the end of fiscal 2008?
- b. How many years are left in the lives of Petrobras' "Equipment and other assets," on average? State clearly any assumptions that you make in arriving at your estimate.
- c. Suppose that Petrobras assumes a zero salvage value for their "Equipment and other assets." For each \$100 in new asset investments, what is the annual amount of depreciation expense charged to the income statement?
- d. Suppose that other leading energy companies charge \$12 in depreciation expense for each \$100 invested in new equipment. Are Petrobras' depreciation policy assumptions materially different from those of their competitors? Support your answer.
- e. What line item on Petrobras' income statement is most affected by their depreciation policy? Explain why.
- f. Aside from comparing Petrobras' depreciation policy assumptions to those of their competitors, what other "red flags" might one look for in order to assess whether Petrobras is overly conservative or overly aggressive in taking depreciation expenses? Is there any evidence of these issues on Petrobras' financial statements?
- d. Noise abatement kits were installed on some of the older A320s in accordance with EU regulations on maximum allowable noise levels on takeoff. The equipment and installation cost €14 million.
- e. The airline painted several of its aircraft as part of a campaign to promote new routes to Asia. The painting cost €1.2 million.
- f. The existing seats on several A320s were replaced with more comfortable seats costing €3.5 million.
- g. New jet engines were installed on several A318s. The total cost was €42 million.

**Statements of Income**

December 31, 2008 and 2007

(In thousands of reais, except net income per share)

Statements of Income	Note	Consolidated	
		2008	2007
<b>Gross operating revenues</b>			
Selling expenses			
Products		266,217,208	218,050,202
Services, mainly freight		276,872	203,972
		<u>266,494,080</u>	<u>218,254,174</u>
Sales charges		(51,375,544)	(47,676,449)
<b>Net operating revenues</b>		<b>215,118,536</b>	<b>170,577,725</b>
Cost of products and services sold		(141,623,359)	(104,398,043)
<b>Gross profit</b>		<b>73,495,177</b>	<b>66,179,682</b>
<b>Operating income (expenses)</b>			
Selling expenses		(7,162,264)	(6,059,734)
Financial			
Expenses	18	(4,193,135)	(3,292,002)

(Continued)

Taxes and contributions	20.1	9,641,247	7,781,536
Prepaid expenses		1,393,879	1,429,829
Other current assets		1,461,801	1,493,200
		<u>63,575,278</u>	<u>53,373,766</u>
<b>Noncurrent assets</b>			
<b>Long-term receivables</b>			
Trade accounts receivable, net	6	1,326,522	2,901,902
Petroleum and alcohol account – STN	9	809,673	797,851
Marketable securities	10	4,066,280	3,922,370
Project financing	11.2		
Deposits in court	12	1,853,092	1,693,495
Prepaid expenses		1,400,072	1,514,301
Advance for pension plan	21		1,296,810
Deferred income and social contribution taxes	20.3	10,238,308	8,333,490
Inventories	8	303,929	236,753
Other long-term receivables		1,256,96	1,325,865
		<u>21,254,843</u>	<u>22,022,837</u>
<b>Investments</b>	13	5,106,495	7,822,074
<b>Property, plant, and equipment</b>	14	190,754,167	139,940,726
<b>Intangible assets</b>	15	8,003,213	5,532,053
<b>Deferred charges</b>		3,469,846	2,536,344
		<u>228,588,564</u>	<u>177,854,034</u>
		<u>292,163,842</u>	<u>231,227,800</u>

**Property, Plant, and Equipment By Type of Asset**

	Estimated Useful Life in Years	Consolidated			
		2008		2007	
		Cost	Accumulated Depreciation	Net	Net
Buildings and improvements	25 to 40	9,382,619	(3,115,564)	6,267,055	3,800,350
Equipment and other assets	3 to 30	119,999,208	(55,854,051)	64,145,157	49,414,524
Land		1,138,720		1,138,720	854,848
Material		6,034,143		6,034,143	4,247,098
Advances to suppliers		5,189,735		5,189,735	2,624,093
Expansion projects		59,238,898		59,238,898	39,964,366
Oil and gas exploration and production development costs (E&P)		83,883,258	(35,142,799)	48,740,459	39,035,447
		<b>284,866,581</b>	<b>(94,112,414)</b>	<b>190,754,167</b>	<b>139,940,726</b>