

Article

Improving the Procedure for Presenting Non-Current Assets in Financial Statements

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Abstract: The study of this article examines the theoretical and methodological aspects of improving the classification and presentation of non-current assets in financial statements. Attention is paid to distinguishing property, plant and equipment from investment property according to their economic substance rather than merely their legal form, ownership status, inventory number, or accounting title. The study analyses the approaches of foreign and local researchers, as well as the requirements of IAS 16 "Property, Plant and Equipment" and IAS 40 "Investment Property." Based on the research findings, a five-stage methodology for classifying non-current assets is proposed. The methodology considers the source and form of expected economic benefits, the purpose and duration of asset use, associated risks and control, residual value, and disposal opportunities. It also provides for documenting classification decisions, reviewing asset categories when their use changes, and reflecting relevant criteria in the entity's accounting policy. The proposed approach helps distinguish property, plant and equipment from investment property more accurately, select appropriate measurement and depreciation methods, reduce subjectivity in accounting decisions, and improve the reliability, transparency, relevance, and comparability of financial statement information.

Keywords: non-current assets, property, plant and equipment, investment property, asset classification, economic substance, financial statements, accounting policy, IAS 16, IAS 40.

Citation: Kuzieva, D. B. Improving the Procedure for Presenting Non-Current Assets in Financial Statements. American Journal of Economics and Business Management 2026, 9(9), 423-428

Received: 13th Jun 2026

Revised: 28th Jul 2026

Accepted: 15th Aug 2026

Published: 12th Sep 2026



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1. Introduction

The appropriate recognition, reliable measurement, and faithful presentation of non-current assets in financial statements directly depend on their proper classification according to their economic substance. In practice, the legal form of an asset, ownership rights, inventory number, or the name assigned to it in the accounting records is often used as the primary criterion for classifying the asset into a particular category. However, this approach does not sufficiently consider that assets with similar external characteristics may be used to perform different economic functions.[1][2]

For example, a building owned by an entity may be used for production activities, administrative purposes, the generation of rental income, or obtaining economic benefits from a future increase in its market value. Although the legal form of the asset remains unchanged and it continues to be identified as a building in each case, its purpose of use and the source of the expected economic benefits differ. Consequently, accounting for assets that perform different economic functions within a single accounting category reduces the economic relevance and reliability of the information presented in financial statements, as well as its usefulness for decision-making.[3][4]

The Conceptual Framework for Financial Reporting establishes that information should faithfully represent not only the legal form of economic transactions but also their

economic substance. Giving priority to economic substance over legal form is an essential condition for faithful representation.

In this regard, as a result of studying the research of some economists, it should be noted that the studied approaches proposed classifying assets according to their purpose of use, economic function, income-generating nature, or duration of use. However, in most of them, these criteria were used separately and a single sequential classification algorithm was not formed.[5]

Foreign economists D. Kizo, J. Weigandt, and T. Warfield classify fixed assets as long-term and tangible assets purchased for use in the usual operational activities of the enterprise. Land held for speculative purposes is considered an investment, and land acquired for resale in the normal course of business is considered a reserve. They evaluate the asset on the basis of such criteria as the purpose of use, participation in operational activities, non-sale, duration of use, material form.

V.G. Belolipetsky divides enterprise assets into four groups depending on the economic function they perform: assets serving production capacity; assets protecting them from risks; investment assets related to business expansion; assets not directly related to production capacity. It is assessed based on criteria such as economic function, connection with production capacity, risk coverage, and business expansion. At the same time, I.A. Lukashova and E.M. Golovashchenko justify the concept of "investment assets" as a broader accounting category than investment real estate. They propose classifying investment assets by their term of ownership, purpose, and form of existence. In their opinion, it is appropriate to assess assets based on criteria such as short-term or long-term, purpose, tangible, intangible, or financial form, and the nature of their participation in the activities of the enterprise. Also, N.V. Ignatova justifies the need to separate investment real estate from fixed assets as a separate accounting object. The fact that the property is held for rental income or appreciation is considered the main feature that distinguishes it from operating real estate. It is assessed based on criteria such as rental income, appreciation, direct use by the owner, and the source of cash flow from the asset. J.R. Dietrich, M.S. Harris and K.A. Muller on the other hand, consider investment property as a group of assets that can be valued independently and examine the relationship between its fair value and future sale price. They show that valuations involving an external appraiser are more reliable. They investigate whether the separation of investment property from fixed assets is justified not only by its intended use, but also by its independent market value and cash flow.[6][7]

Among other scientists, A.Z. Avlokulov is one of the first researchers to study the accounting and auditing of investment property as a special object of research. The scientist showed that the generalization of investment property in the structure of fixed assets does not fully reveal their economic content, and justified the need to separate it as an independent accounting and audit object. This approach requires the adoption of such characteristics as the purpose of using real estate, the expected economic profit from it, and the growth of the asset value as the main criteria for classification. In his opinion, rather than generalizing investment property in the structure of fixed assets, it justifies the need to separate it as an independent accounting and audit object. According to the scientist's approach, when classifying real estate, not its material form, but the purpose of using the asset and the expected economic profit from it should be the priority. Real estate held for the purpose of receiving rental income or increasing capital value is considered investment property, and an object used for production, service, and administrative purposes is considered fixed assets. K.B. Orazov and E.D. Muydinov propose to take into account the purpose of use of the asset and a separate standard that regulates it when classifying fixed assets according to the requirements of the IFRS. They emphasize that investment real estate, assets held for sale, assets related to discontinued operations, and biological assets should be separated from the composition of fixed assets. In addition, D.E. Norbekov, A.N. Toraev and Sh.Sh. Rahmonov view investment real estate as real estate held for the purpose of receiving rental payments, capital appreciation, or both. Objects kept for production, service, administrative purposes or sale in normal activities are excluded from this category. S.N. Tashnazarov noted that when classifying long-term

assets, it is advisable to take into account the economic substance of each asset, its purpose of use and the IFRS applicable to it. Production and administrative facilities are classified under IFRS 16, real estate held for rental or capital appreciation under IFRS 40, and assets held for sale under IFRS 5.[8][9]

2. Materials and Methods

The study employed a qualitative and methodological research design to examine the classification and presentation of non-current assets in financial statements. The research materials included local and international academic literature on non-current assets, property, plant and equipment, and investment property. The regulatory framework of the study comprised the Conceptual Framework for Financial Reporting, IAS 16 "Property, Plant and Equipment," IAS 40 "Investment Property," IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations," and other relevant accounting regulations.[10][11]

The research applied comparative analysis, systematisation, classification, grouping, logical generalisation, and scientific abstraction. The approaches proposed by local and foreign scholars were compared according to such characteristics as the economic function of an asset, its intended use, the source and form of expected economic benefits, the duration of use, the level of control, associated risks, residual value, and disposal opportunities. This comparison made it possible to identify the common features, differences, strengths, and limitations of traditional, functional, and economic-substance-based approaches to asset classification.

A systematic approach was used to develop an integrated set of classification criteria. Unlike the traditional approach, which mainly relies on legal ownership, physical form, inventory number, or accounting title, the proposed approach gives priority to the actual economic substance and function of an asset. Attention was paid to whether the asset generates operating income, cost savings, rental income, capital appreciation, or independent cash flows.

3. Result

As a result of systematising the scientific views of foreign and local economists, the study provides a scientific justification for classifying property, plant and equipment and investment property not merely according to their physical and tangible characteristics, but on the basis of an integrated set of interrelated criteria reflecting their economic function, intended use, the form in which economic benefits arise, the distribution of control and risks, and the possibilities for disposal. Accordingly, the study proposes implementing a five-level methodology aimed at classifying property, plant and equipment and investment property in accordance with their economic substance.[12]

The findings obtained during the study indicate that the traditional classification approach is primarily based on the legal form of an asset and gives priority to the following characteristics:

1. The existence of ownership rights;
2. The form of ownership;
3. The name assigned to the asset in the accounting records.

Under this approach, insufficient attention is paid to the economic function performed by the asset in the entity's activities, the specific purpose for which it is used, and the nature of the economic benefits generated by the asset.

The new approach proposed in this study gives priority to the economic substance of an asset rather than its legal form. Under this approach, the following factors are established as the principal criteria for classifying an asset into the appropriate category:

1. The economic benefits expected to be derived from the asset;
2. The purpose for which the asset is used;
3. The manner in which economic benefits are generated;
4. The useful life of the asset;
5. The level of control over the asset and the associated risks;

6. The possibilities for selling or otherwise disposing of the asset.

4. Discussion

These criterias should not be applied separately but within an integrated and interconnected system. A classification decision based on a single criterion may not fully reflect the actual economic substance and characteristics of an asset. According to the proposed approach, the decisive classification factor is not the name or legal form of the asset, but the economic function it performs in the activities of the reporting entity.[13]

The first classification criteria is the source of economic benefits. This criterion is intended to determine how an asset generates economic benefits for the entity. Such benefits may take the form of operating income from the production and sale of goods, revenue from services, cost savings resulting from reduced expenditure, rental income, an increase in the asset's value, or gains from its future sale. IAS 40 also establishes that a key distinguishing characteristic of investment property is its ability to generate cash flows largely independently of the entity's other assets.[14]

The second criteria is the purpose for which the asset is used. This criterion focuses not on the type of asset, but on the purpose for which the entity holds it and how it is actually used. An asset with the same physical form may be classified differently depending on its intended use.

The third criteria is the duration of use. For an asset to be classified as a non-current asset, it must be expected to be used for more than one reporting period. In practice, this often refers to a period exceeding 12 months. However, under IAS 16, the principal criterion is not a strictly defined 12-month period, but the expectation that the asset will be used for more than one period. When determining the duration of use, it is inappropriate to consider only the asset's physical service life. For example, an asset may technically remain operational for ten years, while the entity plans to use it for only two years. Therefore, the duration of use should be determined by considering the asset's technical capacity, the entity's production plans, the risk of technological obsolescence, maintenance policy, the term of the lease agreement, market demand, and management's strategy for using the asset.[15]

The fourth criteria is control over the asset and the associated risks. The asset must be controlled by the entity, there must be an opportunity to obtain future economic benefits from it, and the ability of other parties to access those benefits must be restricted. Control is not determined solely by legal ownership. In certain circumstances, an entity may not be the legal owner of an asset but may nevertheless control its use and obtain economic benefits from it under a contractual arrangement. Right-of-use assets are an example of such a situation. In assessing control, consideration should be given to who makes decisions concerning the use of the asset, who receives the income generated by it, who bears the costs of its maintenance and repair, and which party assumes the risks associated with changes in its value and accidental loss.

The fifth criteria is the residual value and the possibility of disposing of the asset. Residual value represents the amount that an entity expects to obtain from selling or otherwise disposing of an asset at the end of its useful life, after deducting the estimated costs of disposal. The residual value directly affects the depreciable amount of the asset. The higher the residual value, the lower the amount subject to depreciation.

Thus, in classifying property, plant and equipment and investment property, the source of economic benefits indicates how the asset generates benefits for the entity; the purpose of use explains why the asset is held; the duration of use determines the periods over which economic benefits are expected to be obtained; control and risks identify the party entitled to those benefits and responsible for the related losses; and residual value and disposal possibilities reflect the asset's economic prospects after the end of its useful life. The interrelated application of these criteria makes it possible to determine the true economic nature of the asset.

The proper classification of property, plant and equipment and investment property is one of the initial and most important stages in organising accounting. The classification outcome determines which accounting standard should be applied to the asset, which

measurement model should be selected, how depreciation and impairment should be recognised, and under which item the asset should be presented in the financial statements. Therefore, the classification process should not be limited to identifying the name or physical form of an asset. It should be based on a step-by-step analysis of its economic substance, purpose of use, and expected future economic benefits.

The proposed algorithm includes the following stages: determining the expected economic benefit from the asset, assessing the purpose and method of use, determining the period and duration of use, determining the form of economic benefit, assessing the residual value and the possibility of exiting the asset, and determining the final classification category. Each stage of the algorithm is based on the results obtained in the previous stage. Thus, the classification decision is based not on a single characteristic, but on a system of interrelated criteria.

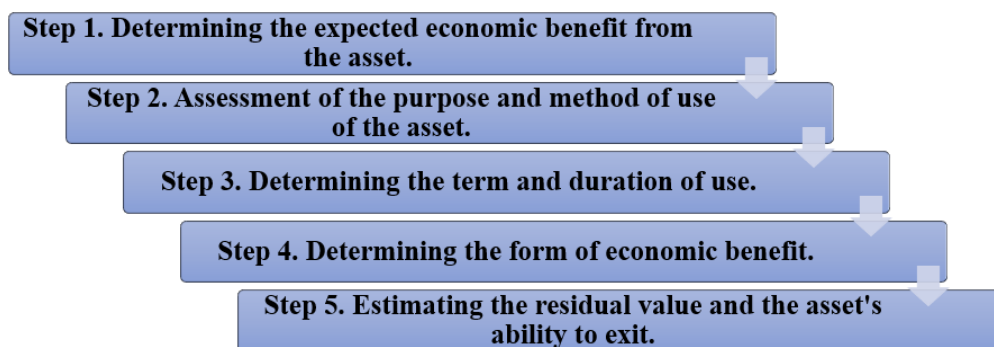


Figure 1. Algorithm for classification of fixed assets and investment real estate
Source: developed by the author

5. Conclusion

The five-stage classification methodology proposed in this study, which is based on economic substance, includes identifying the economic benefits expected from an asset, assessing its intended use, determining its useful life, identifying the form of economic benefits, and analysing its residual value and disposal opportunities. These stages provide a well-founded basis for classifying an asset either as property, plant and equipment under IAS 16 or as investment property under IAS 40.

A key feature of the proposed algorithm is that it gives priority not to the asset's initial designation or legal form, but to its actual use as of the reporting date. It also allows mixed-use properties to be accounted for separately by component, assets to be reclassified when their purpose of use changes, and such changes to be supported by appropriate documentation. This reduces subjectivity in the classification process and the risk of unjustified transfers between accounting categories. Consequently, the economic substance of non-current assets is more fully reflected in financial statements, thereby improving the faithful representation, comparability, and usefulness of financial information for management decision-making.

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