
Project	Annual Improvements
Topic	IAS 16 <i>Property, Plant and Equipment</i>—revaluation model and proportionate restatement

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to address a concern arising from the use of the revaluation method. More specifically, the concern is over the computation of the accumulated depreciation at the date of the revaluation in paragraph 35 of IAS 16 *Property, Plant and Equipment*.
2. The full text of the submission is reproduced in Appendix A to this paper.

Purpose of the paper

3. The objective of this paper is to:
 - (a) outline the issue;
 - (b) provide an analysis of the issue;
 - (c) assess the issue against the Annual Improvements criteria;
 - (d) make a recommendation that the Board should amend IAS 16 through Annual Improvements; and

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

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- (e) ask whether the Interpretations Committee agrees with the staff's recommendation.

The issue

4. The submitter expresses concern over the word 'proportionately' in paragraph 35(a) of IAS 16. The submitter identifies that a proportionate restatement of accumulated depreciation is not possible in cases where the residual value, the useful life or the depreciation method has been re-estimated before a revaluation.
5. The submission provides an example of a situation where there is concern over the restatement of the accumulated depreciation that cannot be proportionate to the restatement of the gross carrying amount after revaluation. The fact pattern specific to the situation described includes:
 - (a) the residual value of an item of property, plant and equipment (PPE) that is accounted for under the revaluation model is revised in year 3, but no revaluation occurs in that period for the net carrying amount of the item; and
 - (b) a revaluation occurs in year 5 in which the gross carrying amount and the net amount are restated to CU 1 200 and CU 975 respectively.
6. According to the submitter, divergent views exist as to how to compute the accumulated depreciation when an item of PPE is revalued:
 - (a) View A: the restatement of the accumulated depreciation is not always proportionate to the change in the gross carrying amount and paragraph 35(a) of IAS 16 should be amended accordingly;
 - (b) View B: the accumulated depreciation and the gross carrying amount should always be restated proportionately when applying paragraph 35(a) of IAS 16.

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7. The submission notes that proponents of view B claim that the difference between the amount required for a proportionate restatement and the actual restatement required to result in a carrying value equal to the revalued amount, should be treated as an accounting error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Staff's analysis

8. We understand that, in the situation described in the submission, the revalued amounts for the gross and net carrying amounts both reflect observable data.
9. We note that if the 'proportionate' method were applied in accordance with view B, the gross carrying amount would be higher than the amount of CU 1 200.
10. As a result, the current wording in paragraph 35(a) of IAS 16 would lead to an overstatement of the gross carrying amount if view B was applied.
11. With respect to the submitter's example, another consequence of view B is that there would be a need to determine the difference between:
 - (a) the gross carrying amount calculated as a proportion of the net carrying amount; and
 - (b) the gross carrying amount determined in accordance with observable data at the time of the revaluation.

That difference would have to be recognised in profit or loss.

12. We do not support this method, because point (a) above does not reflect the measure of the gross carrying amount at the time of the revaluation. We think that accounting for the difference as an error would be misleading.
13. In addition, we note that paragraph 73(d) of IAS 16 requires the disclosure of the gross carrying amount and the accumulated depreciation. Consequently, we believe that an overstatement of the gross carrying amount of the item of PPE being revalued would be misleading to users (as would an understatement).

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14. In our opinion, view B does not accommodate the effects of past revisions to residual value, useful life or depreciation method.
15. We therefore favour view A as the appropriate path forward, because this would allow the gross carrying amount to reflect observable data at the time of the revaluation.
16. In addition, we note that the second sentence in paragraph 35(a) of IAS 16: ‘Proportional restatement is often used when an asset is revalued by means of applying an index to determine its depreciated replacement cost’ might be misleading because the determination of the accumulated depreciation does not depend on the selection of the valuation technique used to measure fair value.
17. We also note that paragraph 80(a) of IAS 38 *Intangible Assets* contains the same requirements for the calculation of the accumulated depreciation when an intangible item is revalued. If an improvement were to be made to IAS 16, we believe that the same improvement as for paragraph 35 of IAS 16 should be made to paragraph 80(a) of IAS 38.
18. We therefore recommend that paragraph 35(a) of IAS 16 should be amended to reflect view A discussed in paragraph 6 of this paper. We also recommend that as part of the proposed amendment, the last sentence of paragraph 35(a) of IAS 16 should be deleted. In addition, we recommend that paragraph 80(a) of IAS 38 be amended accordingly.

Assessment against the Annual Improvements criteria

19. For ease of reference the criteria are reproduced in full in Appendix B to this paper. We analyse below the proposed amendment against those criteria:

(a) *The proposed amendment clarifies or corrects existing IFRSs*

We believe that the guidance to calculate the gross carrying amount and the accumulated depreciation when an item of PPE under the revaluation method is revalued could be clarified.

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- (b) *The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.*

The proposed improvement is for specific situations addressed by paragraph 35(a) of IAS 16. We believe these situations are well-defined and sufficiently narrow in scope. We note that paragraph 80 of IAS 38 has the same requirements and that an amendment to paragraph 35(a) of IAS 16 would entail the same amendment to paragraph 80 of IAS 38.

- (c) *It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.*

We believe that the IASB could reach a conclusion on a timely basis on this issue.

- (d) *If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.*

The proposed improvement does not relate to an IFRS that is the subject of a current or planned project.

20. Consequently, we think that the issue is a candidate for Annual Improvements.

Staff's recommendation

21. We think that the Interpretations Committee should recommend that the Board should proceed with the proposed improvement described in paragraph 18 of this paper.
22. If the Interpretations Committee agrees with our recommendation, we propose a draft amendment to paragraph 35(a) of IAS 16 and to paragraph 80(a) of IAS 38 in Appendix C to this paper.

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Question to the Interpretations Committee

Questions—staff's recommendation

- (1) Does the Interpretations Committee agree with the staff's recommendation
- (2) Does the Interpretations Committee have comments on the draft wording for the proposed amendment?

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Appendix A

Appendix A—Submission

INTRODUCTION

IAS 16 *Property, Plant and Equipment* permits either of two alternative methods for the treatment of accumulated depreciation when an asset is revalued using the revaluation model¹:

- 35 When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to determine its depreciated replacement cost; or
 - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 39, Aus39.1, 40, Aus40.1 and Aus40.2.

Paragraph 51 requires that the *residual value* and *useful life* be reviewed at least annually and any "change(s) shall be accounted for as a change in an accounting estimate in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors", i.e. prospectively.

Similarly paragraph 61 requires that the *depreciation method* applied to an asset be reviewed at least annually, and again any change is to be accounted for as a change in accounting estimate in accordance with AASB 108.

In this submission we have used the term *gross restatement method* to refer to the procedure in paragraph 35(a) of IAS 16.

THE ISSUE

We contend that in any instance where any one or more of *residual value*, *useful life* or *depreciation method* have been changed as a result of the required annual review, ***it will be impossible to proportionately restate accumulated depreciation with the change in gross carrying amount of the asset so that the carrying amount of the asset equals its revaluation amount.***

The following simple example illustrates our point.

Example

On acquisition, an asset acquired at a cost of CU1,000 is estimated have a *residual value* of CU200, a *useful life* of 20 years, and straight line to be the appropriate depreciation method.

At the commencement of the third year, the estimated *residual value* is revised to CU250 (25% of purchase price).

1. Text has been extracted from Australian Standard AASB 116, which we understand is identical to IAS 16 except for the references to "Aus" paragraphs.

**IASB Staff paper
Appendix A**

At the end of the fifth year the asset is revalued using the gross restatement method; the new gross carrying amount is CU1200 and fair value CU975 (and hence accumulated depreciation CU225). (Estimated residual value at the time of revaluation was CU300 - 25% of purchase price.)

The gross carrying amount, accumulated depreciation and net carrying amount would be as per the table.

Reporting Period	Gross Carrying Amount (CU)	Accumulated Depreciation (CU)	Net Carrying Amount (CU)
At acquisition	1,000	0	1,000
End year 1	1,000	40	960
End year 2	1,000	80	920
End year 3	1,000	117	883
End year 4	1,000	155	845
End year 5 (before revaluation)	1,000	192	808
End year 5 (after revaluation)	1,200	225	975
Revaluation Increment	200	33	167
as % of pre-revaluation amounts	20%	17%	21%

Based on our calculations, and excepting merest chance, any change in the accounting estimates for *residual value*, *useful life* or *depreciation method* will have the same result - the restatement of accumulated depreciation cannot be **proportional** to the change in gross carrying amount if the resulting carrying value is to equal the revalued amount.

We have become aware of auditors insisting that the difference between the amount required for a proportional restatement, and the actual restatement required to result in a carrying value equal to the revalued amount, to be treated as an accounting error. While we have argued that this is to effectively require the effects of changes in *residual value*, *useful life* or *depreciation method* to be retrospectively adjusted, our arguments have been unsuccessful.

RECOMMENDATION

That the word "proportionately" be deleted from paragraph 35(a).

We are also of the view that the Standard should require that whichever method (i.e. 35(a) or 35(b)) is used, must be used for all assets within the relevant class, and that a change in method adopted for a particular class of assets should be required to be treated as a change in accounting policy in accordance with AASB 108.

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Appendix B

Appendix B – Qualifying assessment criteria for Annual Improvements

Below is reproduced for ease of reference paragraph 65A of the *Due Process Handbook for the International Accounting Standards Board* as amended by the Trustees in February 2011:

- 65A In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.
- (a) The proposed amendment has one or both of the following characteristics:
- (i) clarifying—the proposed amendment would improve IFRSs by:
- clarifying unclear wording in existing IFRSs, or
 - providing guidance where an absence of guidance is causing concern.
- A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.
- (ii) correcting—the proposed amendment would improve IFRSs by:
- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or
 - addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.
- A correcting amendment does not propose a new principle or a change to an existing principle.
- (b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.
- (c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.
- (d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

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Appendix C

Appendix C– Proposed improvement

Proposed amendment to IAS 16 *Property, Plant and Equipment*

Paragraph 35(a) is amended (new text is underlined and deleted text is struck through) and paragraph 81G is added.

Measurement after recognition

Revaluation model

- 35 When an item of property, plant and equipment is revalued, ~~any~~the gross carrying amount and the accumulated depreciation at the date of the revaluation ~~is~~ are treated in one of the following ways:
- (a) the gross carrying amount is restated proportionately in a manner consistent with the revaluation of change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued carrying amount. The accumulated depreciation is the difference between the gross and the net carrying amounts. For example, the gross carrying amount may be restated by reference to an observable data or it may be restated proportionately with the change in the net carrying amount. ~~Proportional restatement is often used when an asset is revalued by means of applying an index to determine its depreciated replacement cost.~~
 - (b) the accumulated depreciation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. For example, ~~This method is often used for buildings.~~

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 39 and 40.

Effective date and transition

Effective date

- 81G *Improvements to IFRSs* issued in [date] amended paragraph 35. An entity shall apply that amendment for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

IASB Staff paper
Appendix C

Appendix to proposed amendment to IAS 16 *Property, Plant and Equipment*

Amendment to other IFRSs

IAS 38 *Intangible Assets*

Paragraph 80(a) is amended (new text is underlined and deleted text is struck through) and paragraph 130H is added.

Measurement after recognition

Revaluation model

- 80 If an intangible asset is revalued, ~~any~~the gross carrying amount and the accumulated amortisation at the date of the revaluation is ~~are either~~ treated in one of the following ways:
- (a) the gross carrying amount is restated proportionately in a manner consistent with the revaluation change in of the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued carrying amount. The accumulated amortisation is the difference between the gross and the net carrying amounts. For example, the gross carrying amount may be restated by reference to an observable data or it may be restated proportionately with the change in the net carrying amount.
 - (b) the accumulated amortisation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

Effective date and transition

Effective date

- 130H *Improvements to IFRSs* issued in [date] amended paragraph 80. An entity shall apply that amendment for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

IASB Staff paper
Appendix C

**Basis for Conclusions on proposed amendment to IAS 16
*Property, Plant and Equipment***

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

**Restatement of accumulated depreciation when an item of PPE is
revalued**

- BC1 In response to an unintended consequence arising from the guidance on the restatement of accumulated depreciation when an item of PPE is revalued, the Board proposes to amend the guidance to accommodate the effects of past revisions to residual value, useful life or depreciation method. The proposed improvement focuses on the restated depreciation as the difference between the restated gross carrying amount and the restated net carrying amount. As such, it proposes to delete the reference to the depreciated replacement cost valuation method.