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Project **Annual Improvements—2010-2012 cycle**

Topic **IAS 16 *Property, Plant and Equipment*—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 as specified in paragraph 35 of IAS 16 *Property, Plant and Equipment*.

2. The Interpretations Committee discussed the issue at its meeting in May 2010. Its recommendation is presented in this paper.

Purpose of the paper

3. The purpose of this paper is to ask the Board whether it approves an annual improvement to IAS 16 *Property, Plant and Equipment* (PPE) and to paragraph 80(a) of IAS 38 *Intangible Assets* that would reflect the fact that restatement of the accumulated depreciation is not always proportionate to the change in the gross carrying amount of the asset.

4. This paper:

   (a) provides background information and explains the issue;

(b) makes a recommendation for:

  (i) proposed amendments to IAS 16 and IAS 38 as presented in Appendices A and B;

  (ii) an assessment of the proposed amendments against the criteria for inclusion in Annual Improvements; and

(c) asks the Board whether they agree with the recommendation.

Background information

5. 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.

6. The submission received provides an example with a specific fact pattern described in Appendix A to agenda paper 9 that was presented at the Interpretations Committee meeting in May 2011[1].

7. More specifically, concern is expressed 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.

[1] http://www.ifrs.org/NR/rdonlyres/CA0037B7-1DB5-4124-BA5F-E4943164872A/0/091105ob09IAS16Revaluationmodel.pdf

8. According to the submitter, divergent views exist as to how to compute the accumulated depreciation when an item of PPE is revalued under paragraph 35(a) of IAS 16:

   (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.

9. 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*.

10. At the IFRS Interpretations Committee meeting in May 2011, the Interpretations Committee agreed with the staff proposal to recommend that the Board should add this issue to the 2010–2012 Annual Improvements cycle[2].

Staff analysis

Revaluation model in IAS 16

11. We note that the definition of 'carrying amount' in paragraph 6 of IAS 16 implies that the accumulated depreciation is first and foremost computed as the difference between the gross carrying amount and the net carrying amount of a non-financial asset. Paragraph 6 of IAS 16 is reproduced below for ease of reference:

[2] IFRIC update for May 2011: 'Consequently, the Committee decided to recommend that the Board should amend paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38 through Annual Improvements to reflect the fact that restatement of the accumulated depreciation is not always proportionate to the change in the gross carrying amount of the asset.'

> *Carrying amount* is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

12. We note that paragraph 35(a) of IAS 16 currently requires that, in those instances where the gross carrying amount is revalued, the revalued accumulated depreciation results from applying the same proportionate factor as for the change in the gross carrying amount to the accumulated depreciation before revaluation.

13. We understand that, in the situation described in the submission, the revalued amounts for the gross and net carrying amounts both reflect observable data.

14. 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.

15. 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.

16. In addition, we observe that the determination of the accumulated depreciation does not depend on the selection of the valuation technique used for the revaluation under the revaluation model for non-financial long-term assets in IFRSs.

17. In that respect, we agree that the requirements in paragraph 35(a) of IAS 16 may be perceived as being inconsistent with the definition of 'carrying amount'.

18. In addition, we note that the second sentence in paragraph 35(a) of IAS 16 reinforces that inconsistency in that it states that: 'Proportional restatement is often used when an asset is revalued by means of applying an index to determine its replacement cost'.

Revaluation model in IAS 38

19. We note that paragraph 80(a) of IAS 38 contains the same requirements as paragraph 35(a) of IAS 16 for the calculation of the accumulated depreciation when an intangible item is revalued.

20. 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.

Staff conclusion

21. We therefore recommend that paragraph 35(a) of IAS 16 should be amended to reflect view A as presented in paragraph 8 of this paper.

22. We recommend that as part of the proposed amendment, the last sentence of paragraph 35(a) of IAS 16 should be deleted. For the sake of symmetry and consistency, we recommend that the last sentence of paragraph 35(b) of IAS 16 should be deleted too.

23. In addition, we recommend that paragraph 80(a) of IAS 38 should be amended accordingly.

Assessment against the Annual Improvements criteria

24. We have assessed below the issue against the Annual Improvements 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.

(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 that are 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.

25. In our opinion, the issue satisfies the Annual Improvements criteria.

Transition provisions

26. We believe that the transition provisions for these proposed amendments should be in line with the general principle on accounting for a change in accounting policy in accordance with paragraph 22 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The transition provisions for the proposed amendments therefore require retrospective application.

Consequential amendments

27. We reviewed other IFRSs for possible consequences of the proposed improvements. We have not identified consequential amendments triggered by the proposed improvements presented in this paper.

Interpretations Committee's recommendations

28. The Interpretations Committee recommends that the Board should proceed with the proposed improvements described in paragraphs 21 to 23 of this paper.

29. If the Board agrees with the Interpretations Committee's recommendation, we propose draft amendments to paragraph 35(a) of IAS 16 and to paragraph 80(a) of IAS 38 in Appendices A and B to this paper.

30. We note that IFRS 13 *Fair Value Measurement*, published in May 2011, amended paragraph 35 of IAS 16 (but not paragraph 80 of IAS 38); it is effective from 1 January 2013 and early application is permitted. We also note that, if finalised, the amendments we propose to paragraph 35 of IAS 16 in this paper would likely be effective from 1 July 2013 and early application would also be permitted. Because we see no reason to link early application of this amendment to early application of IFRS 13 entities may choose to early apply the proposed amendment to IAS 16 without early applying IFRS 13, we propose to amend both

the current version of IAS 16 (as amended at April 2011) and the version amended by IFRS 13 in May 2011. Proposed amendments are shown in Appendices A and B to this paper.

Questions to the Board

Questions—Interpretations Committee's recommendations
(1) Does the Board agree with the Interpretations Committee's recommendation to improve paragraph 35 of IAS 16 and paragraph 80(a) of IAS 38 through Annual Improvements?
(2) Does the Board have comments on the draft wording for the proposed amendments?

Appendix A—Proposed improvement

Proposed amendment to IAS 16 *Property, Plant and Equipment* (as amended at May 2011)

Paragraph 35 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 market data or it may be restated proportionately with the change in the net carrying amount. ~~This method is often used when an asset is revalued by means of applying an index to determine its replacement cost (see IFRS 13).~~

(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. ~~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 July 2013. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

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 market 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 July 2013. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

IASB Staff paper
Appendix A

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.

Appendix B—Proposed improvement

Proposed amendment to IAS 16 *Property, Plant and Equipment* (as amended at April 2011)

Paragraph 35 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 market data or it may be restated proportionately with the change in the net carrying amount. ~~This method 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. ~~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 July 2013. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

IASB Staff paper
Appendix B

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.