

REPORT

CL 06 12-08d

Committee	CIPFA/LASAAC LOCAL AUTHORITY CODE BOARD
Venue	Barceló Carlton Hotel, North Bridge, Edinburgh
Date	15 December 2008
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Subject	Property, Plant and Equipment Section of Draft IFRS-Based Code

1. INTRODUCTION

- 1.1. At its meeting held on 15 April 2008, CIPFA/LASAAC agreed the format and structure of the IFRS-based Code of Practice.
- 1.2. This report considers the Property, Plant and Equipment section of the draft IFRS-based Code of Practice on Local Authority Accounting, and CIPFA/LASAAC is asked to approve the section or suggest amendments.

2. SUMMARY OF COMPLIANCE WITH STANDARDS / IMPACT

<p>IFRS Compliance / Adaptations</p>	<p>Adaptations are in respect of:</p> <ul style="list-style-type: none"> - the option of restating proportionally the accumulated depreciation and impairment on revaluation will not be allowed, subject to further consideration by CIPFA/LASAAC with regard to the use this option for DRC valuations (detailed in paragraph 3.3) <p>Interpretations are in respect of:</p> <ul style="list-style-type: none"> - the option of using either the cost model or valuation model after recognition for certain classes of assets (detailed in paragraph 3.4) - 'value in use' for assets not held for the purpose of generating cash flows (detailed in paragraph 3.5) - the period of revaluing assets every 3–5 years has been interpreted as a 5-year rolling programme of revaluations to cover a class of assets (detailed in
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	paragraph 3.8)
IPSASB Compliance / Adaptations	Full compliance, no adaptations
i-FReM Compliance / Adaptations	<p>The i-FReM states that '<i>all tangible fixed assets shall be carried at valuation at the balance sheet date – that is, the option given in IAS 16 to measure at cost has been withdrawn, as has the option to value only certain classes of assets</i>' (detailed in paragraph 3.6)</p> <p>The i-FReM allows the use of depreciated historical cost as a proxy for current valuations for non-property with short useful life or low value (detailed in paragraph 3.6)</p> <p>Revaluation gains or losses for fixed assets financed from grants are credited or debited (to the extent that gains have been previously recorded) to a government grant reserve (detailed in paragraph 3.7)</p> <p>The i-FReM permits the use a quinquennial valuation supplemented by annual indexation and no interim professional valuation (detailed in paragraph 3.8)</p>
Changes to SORP	Yes (detailed in paragraphs 3.2)
Impact on Taxation	No impact on taxation; depreciation, revaluation gains or losses and gains or losses on derecognition charged to Statement of Comprehensive Income are transferred to the Capital Adjustment Account and reported in the Statement of Changes in Equity

3. DRAFT CODE

3.1. The accounting requirements for tangible fixed assets are detailed in *IAS 16 Property, Plant and Equipment*. *IPSAS 17 Property, Plant and Equipment* is based on *IAS 16* and introduces no additional requirements, although it provides additional guidance for public sector bodies i.e. the basis for determining fair value and introducing the concept of 'service potential'.

3.2. Many of the requirements are the same as those previously included in the SORP which follows *FRS 15 Tangible Fixed Assets*. Changes to the requirements are summarised below:

- The draft Code uses the same recognition criteria for subsequent expenditure as initial expenditure with regard to capitalisation. The SORP has separate criteria for enhancement expenditure i.e. expenditure can be capitalised where the

expenditure '*extends the economic life of the asset*', which is not a requirement of the draft Code. However, it is not expected that this will result in different accounting treatments.

- The draft Code requires classes of assets using the revaluation model to use fair value or depreciated replacement cost (DRC) for specialist properties. In most cases it is anticipated that there will be no changes to the carrying amounts based on current values calculated under the SORP. However there may be occasions when carrying amounts based on existing use value (EUV) under the SORP are different from fair value i.e. were the alternative use value of the asset is higher
 - A greater emphasis is placed on component accounting under *IAS 16* i.e. the requirement to separately identify two or more components of an asset for depreciation purposes where the useful life or depreciation method is different and the cost of the components are significant in relation to the total cost of the asset
 - The draft Code requires where a component is replaced or restored, the carrying amount of the old component is derecognised and the new component reflected in the carrying amount. This requirement must be done irrespective of whether the component has been separately identified for depreciation purposes (see bullet point above). This is not a requirement under the SORP
 - Unlike the SORP, renewals accounting is not permitted under the draft Code
- 3.3. The option within *IAS 16* of restating proportionally the accumulated depreciation (and impairment) with the change in gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its re-valued amount, is not permitted under the draft Code. The SORP is silent on this matter, but *FRS 15* specifically permits the use of this approach where DRC is used as a method of valuation, but it is considered that this is not widely used by authorities. *IAS 16* allows the use of this approach where DRC is used as a method of valuation. CIPFA/LASAAC are asked to consider whether the draft Code should allow the use of restating proportionally the accumulated depreciation (and impairment) when an asset is re-valued by means of applying an index to determine its DRC.
- 3.4. The option under *IAS 16* to value certain classes of assets after recognition using the cost model (i.e. historical cost) or the revaluation model has been used. The carrying amount of classes of assets valued based on historical cost and fair value or depreciated replacement cost are the same as under the SORP (and as such will minimise the impact on transition – see the second bullet point of paragraph 3.2). The fair value of council dwellings are measured using existing use value-social housing (EUV-SH) which is a method of valuation that is based on fair value with additional special assumptions.
- 3.5. The draft Code identifies an area where the requirements of *IAS 16* should be varied. This is in relation to the definition of 'value in use' for assets that are not held for the purpose of generating cash flows. The definition of 'value in use' in *IAS 16* is the '*future cash flows expected to be derived from an asset or cash-generating asset*'. The interpretation for the public context assumes that 'value in use' is equal to the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential. This interpretation follows *IPSAS 17* and is consistent with the i-FReM.

- 3.6. The i-FReM does not allow the use of the cost model for the valuation of fixed assets after recognition. Under the i-FReM all fixed assets covered by *IAS 16* will be measured using the revaluation model with the exception of non-property assets with a short useful life or low value where the use of depreciated historical cost as a proxy for current valuations is allowed. As stated in paragraph 3.4, the draft Code allows for certain classes of assets; infrastructure, community assets and assets under construction, to use the cost model (i.e. historical cost).
- 3.7. Revaluation gains or losses for fixed assets financed from grants are credited or debited (to the extent that gains have been previously recorded) to a government grant reserve under the i-FReM. This is not allowed under the draft Code where all revaluation gains or losses are credited or debited to a revaluation reserve following the accounting treatment in *IAS 16*.
- 3.8. *IAS 16* suggests a revaluation period of 3-5 years. For the draft Code this has been interpreted as a 5-year rolling programme of valuations to cover a class of assets, which is in line with the current SORP requirements. The valuation methodology of a quinquennial valuation supplemented by annual indexation and no interim professional valuation, allowed under the i-FReM will not be permitted under the draft Code.
- 3.9. The Property, Plant and Equipment section of the draft Code includes adaptations/interpretations for the public sector context that do not directly relate to *IAS 16*, but have been included for clarity and referenced to the relevant section of the draft Code.
- 3.10. Discussions have taken place with the RICS and will continue, with regard to the development of draft Code covering property, plant and equipment. The particular areas that have been developed with the RICS are the potential changes in the carrying amounts of assets where they are based on EUV (see second bullet point of paragraph 3.2), the continued use of EUV-SH for council dwellings because this method of valuation is based on fair value with special assumptions and the practicalities of componentisation.
- 3.11. The RICS Public Sector Valuation Panel is to be consulted following the CIPFA/LASAAC meeting and will incorporate any comments on the use of EUV-SH for council dwellings in the draft Code.
- 3.12. Component accounting may pose particular practical issues with regard to council dwellings where asset records are held at 'archetype' or 'asset group' levels. However the RICS initial view is that in the majority of cases individual components will not be material compared to the overall value of council dwellings and hence will not be required, although this will be for individual authorities to decide.
- 3.13. RICS are very keen to revise the 'Red Book' in line with the Code and provide guidance linked to the Code and associated guidance notes where deemed necessary.
- 3.14. The draft Code uses the term 'infrastructure' in relation to a class of assets, which follows the terminology currently used in the SORP. CIPFA/LASAAC are asked to consider renaming this class of asset in view of the same term being used in the PFI section of the Code (which follows *IFRIC 12* terminology) which has a different meaning.

- 3.15. The draft Code refers to 'Government Grants Deferred Account' and 'Donated Assets Reserve'. CIPFA/LASAAC are asked to note that the accounts to be used in the final version of the Code will depend upon the work that is currently being undertaken with regard to the accounting of government and non-government grants (under *IAS 20* and *IPSAS 23*).
- 3.16. The draft section of the Code covering property, plant and equipment is included as Appendix A.
- 3.17. The draft section of the Code covering the transition arrangements for property, plant and equipment is included as Appendix B. This Appendix does not cover the potential transition issues that may arise from the requirement for component accounting (see the third and fourth bullet points in paragraph 3.2) and renewals accounting (see fifth bullet point in paragraph 3.2). CIPFA/LASAAC are asked to consider whether the requirements of the draft Code should be applied prospectively with regard to these two areas for the reasons of pragmatism and hence mitigate the impact on transition. This view point is taken having regard to the fact that derecognition and recognition of components of assets will be required under the draft Code and renewals accounting is not commonly used by authorities. These issues have not been considered as part of the separate report 'First-time Adoption of IFRS', which appears elsewhere on this agenda.
4. RECOMMENDATION

CIPFA/LASAAC is asked to approve the property, plant and equipment section of the IFRS-based Code of Practice on Local Authority Accounting, or comment on areas where further analysis or changes are requested.