

Accounting for Asset Revaluations in Local Government

Guidance by:

The Chartered Institute of Public
Finance and Accountancy

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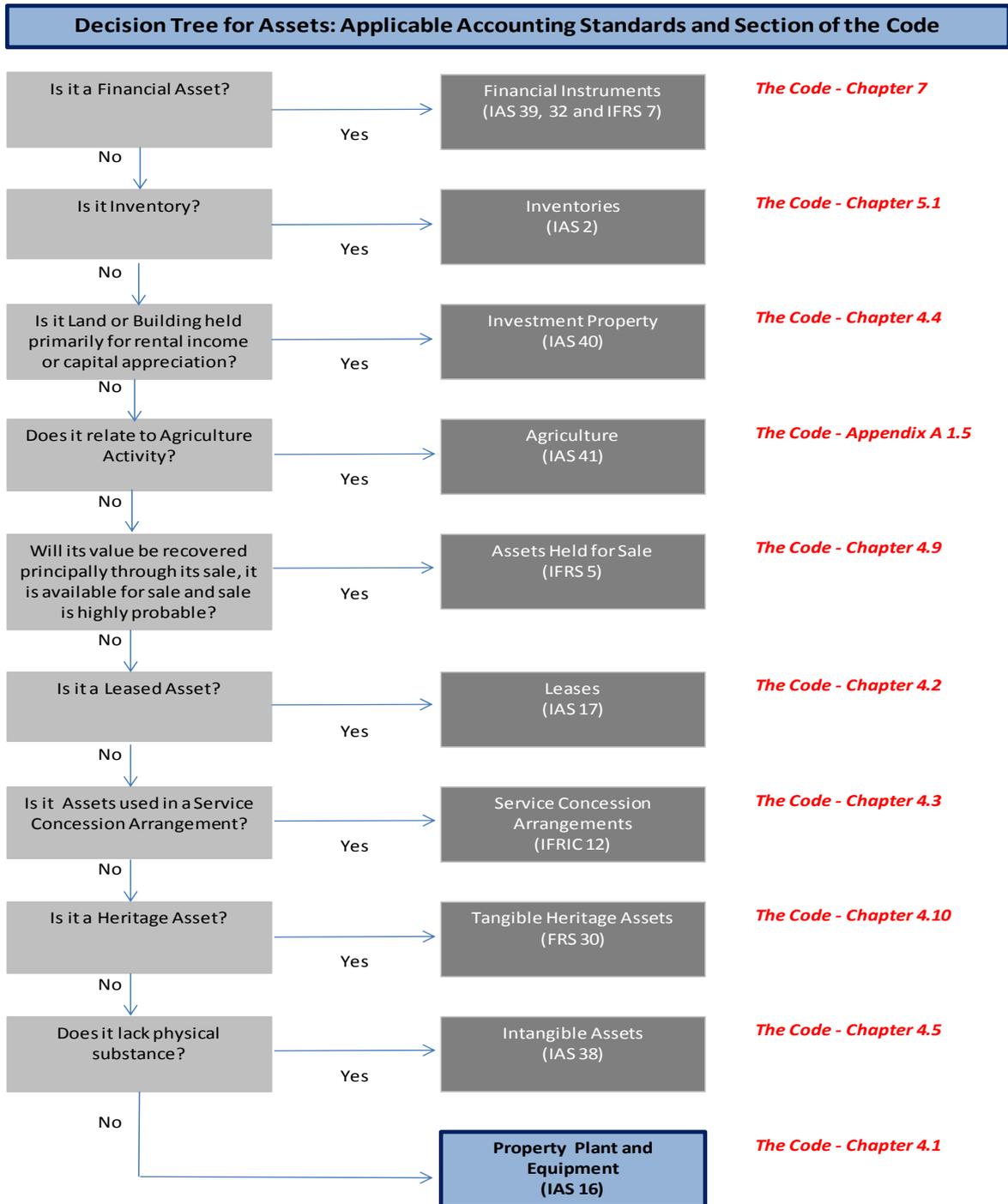
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1. Background

1.1 Chapter 4 of the CIPFA Code of Practice on Local Authority Accounting for 2015/16 (the Code) sets out the accounting requirements for Non-Current Assets. The decision tree table below outlines the applicable accounting standards and corresponding sections of the Code relevant to the main categories of assets.



- 1.2 This guidance focuses on accounting for assets classified under Property, Plant and Equipment and IAS 16 with particular emphasis on accounting for the revaluation of assets.
- 1.3 The underlying concepts and requirements for the valuation and depreciation of typical local government property, plant and equipment assets are consistent with IAS 16. The code does provide additional guidance for local government bodies, particularly in the area of determining the service potential of assets.
- 1.4 In accordance with the Code, infrastructure, community assets (except where the valuation option has been adopted, in accordance with section 4.10 of the Code in respect of heritage assets) and assets under construction (excluding investment property – see section 4.4 of the Code) shall be measured at historical cost. This means the option given in IAS 16 to measure the carrying amount of these classes of assets at fair value has been withdrawn.
- 1.5 All other classes of asset shall be measured at fair value (or in the case of heritage assets, valuation, in accordance with 4.10 of the Code). If there is no market-based evidence of fair value because of the specialist nature of the asset and the asset is rarely sold, authorities may need to estimate fair value using a depreciated replacement cost (DRC) approach.
- 1.6 Local Government has been required to implement the requirements of the Code in relation to accounting for the depreciation of significant components of an asset and the de-recognition of old components and recognition of new components. This requirement applied prospectively for any enhancement and acquisition expenditure incurred, and revaluations carried out, from 1 April 2010.

2. Valuation Frequency

- 2.1 Paragraph 4.1.2.37 of the Code specifies that for assets that are required to be carried at fair value, revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.
- 2.2 As regards to frequency of valuation, the Code requires that assets must be revalued every five years as a minimum, but must be revalued more regularly where a five-yearly valuation is insufficient to keep pace with material changes in fair value.

- 2.3 Paragraph 4.1.2.37 of the Code requires that items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. The Code also allows valuations to be carried out on a rolling basis, but only if revaluation of the class of assets is completed within a short period and provided that revaluations are kept up to date.
- 2.4 There is no requirement in the Code to use indices as a method of valuation in between formal valuation periods. Indices are a useful tool to assist in the assessment of whether or not there has been any material change to the value of a class of assets between formal valuation dates. The use of indices is given very specific references in IAS 16 concerning valuations under depreciated replacement cost (see IAS 16 paragraph 35 a) and should not be used to 'smooth' valuation fluctuations.
- 2.5 Indices should only be used by appropriate valuations experts, in accordance with their professional judgements, when determining the measurements of items of property, plant and equipment. Therefore any previous references to the use of indices has been removed from the Code Guidance Notes effective from the 2015/16 year.
- 2.6 If, when assessing changes to asset values at year-end, in relation to depreciated replacement cost (DRC) valuations, practitioners should be mindful of whether or not the indices provided by LPS take account of depreciation. In Northern Ireland, Land and Property Services (LPS) usually provide indices to the 31 March in a year. However these indices will not take account of depreciation and therefore the indices is applied as at the preceding 1 April and depreciation is applied to the indexed carrying value to arrive at the carrying amount accounted for at the following 31 March.
- 2.7 It should be noted that it is common practice for formal five yearly revaluations in local government to be made as at 1 April. However, the general requirement of the Code is to ensure that the carrying values of non-current assets in local authority balance sheets are materially accurate at 31 March.

3. Valuation Methodologies

- 3.1 The core principles in the code are contained in paragraph 4.1.2.33 and state; when an asset is re-valued, any accumulated depreciation and impairment at the date of valuation shall be eliminated against the gross carrying amount of the asset and the net amount restated to the re-valued amount of the asset. Where authorities use the alternative method of

proportionately restating any accumulated depreciation and impairment at the date of valuation, they should refer to IAS 16.

3.2 There are, therefore, two valuation methodologies potentially allowable under the Code:

1. Eliminating Accumulated Depreciation; and
2. Proportionate Re-statement

These are explained in more detail below.

3.3 **Eliminating Accumulated Depreciation**

The Code expects that accumulated depreciation and impairment will be eliminated when an asset is revalued. This is because these measures are accounting estimates of changes in value relating to the consumption of assets whose cumulative effect is confirmed or contested by a formal valuation reflecting the actual condition of the property at the valuation date. The depreciation and impairment estimates are therefore made redundant by the valuation.

3.4 **Proportionate Re-statement**

However, paragraph 35 of IAS 16 does, though, permit accumulated depreciation to be restated proportionately with the change in the gross carrying amount of an asset. The example given of when this might be appropriate is a (DRC) revaluation based on the application of an index. The Code accepts that authorities might wish to use this approach.

3.5 It should be noted that the Code will change for 2016/17 and the option for proportionate re-statement will be removed. LAAP Bulletin 104 covering the year-end closure for 2015/16 refers to the following under 'accounting standards that have been issued but have not yet been adopted.'

*'The IAS 16 Property, Plant and Equipment option for the treatment of accumulated depreciation and impairment, where the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset (except for the Highways Network Asset) has been withdrawn by CIPFA/LASAAC. Therefore, for property, plant and equipment (other than the Highways Network Asset) **the 2016/17 Code includes an adaptation of IAS 16 to remove the non-elimination option for the treatment of accumulated depreciation and impairment.***

Practitioners should bear this change in mind when selecting the appropriate methodology for revaluations and confirming their accounting policies.

4. Illustrative Examples

4.1 The following example (see below) covers the adjustments resulting from a revaluation using the methodology of eliminating accumulated depreciation, the expected method in the Code following a revaluation exercise.

4.2 The assumptions in the following illustrative examples include:

- The original asset has a useful life of 30 years
- At 31/3/20XX it is 10 years into its useful economic life
- The asset was revalued three years ago and has a revaluation reserve balance at 31/3/20XX of £1,106,768
- The current carrying value at 31/3/20XX is £3,040,435
- Revaluation has been carried out resulting in a value of £3,319,140 applied at the 1/4/20XX consistent with the authority's policy.

Illustrative Example

1. REVALUATION - Eliminating Accumulated Depreciation

	CURRENT VALUES			HISTORICAL VALUES			Revaluation Reserves
	Value	Depn	NBV	Value	Depn	NBV	
As at 31/3/20XX	3,496,500	(456,065)	3,040,435	2,900,500	(966,833)	1,933,667	1,106,768
As at 1/4/20XX	3,319,140	0	3,319,140				
Adjustment	(177,360)	456,065					

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Property, Plant and Equipment		177,360
Accumulated Depreciation	456,065	
Revaluation Reserves		278,705

Revaluation Reserve Reconciliation

New Carrying Amount	3,319,140
Historic Cost Carrying Value	1,933,667
Difference in Revaluation Reserve	<u>1,385,473</u>
Existing Revaluation Reserve	1,106,768
Adjustment at 1/4/20XX	278,705
New Revaluation Reserve	<u>1,385,473</u>

Rolling Forward:

1. REVALUATION - Eliminating Accumulated Depreciation

	CURRENT VALUES			HISTORICAL VALUES			Revaluation Reserves
	Value	Depn	NBV	Value	Depn	NBV	
Op Bal As At 1/4/20XX	3,319,140	0	3,319,140	2,900,500	(966,833)	1,933,667	1,385,473
Depreciation Charge in Year		(150,870)	(150,870)		(96,683)	(96,683)	(54,187)
Cl Bal As At 31/3/20XY	<u>3,319,140</u>	<u>(150,870)</u>	<u>3,168,270</u>	<u>2,900,500</u>	<u>(1,063,516)</u>	<u>1,836,984</u>	<u>1,331,286</u>

The above example covers a revaluation and applying the new value as at the 1st April. This example uses the approach of eliminating the accumulated depreciation against the gross carrying amount. This is an upwards revaluation, therefore adding to the existing revaluation reserve balance. The roll forward takes the transactions through to the end of the financial year, 31/3/20XY.

4.3 **Prior-year Restatement Considerations**

The Code, paragraph 3.3, refers to changes in accounting policies, changes in accounting estimates and errors. Valuations, whether using indices as a proxy or taking account of a formal valuation, are based on judgements or in effect estimates at that point in time reflecting market conditions and other factors. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error and therefore should not normally require prior year restatement. Changes to accounting estimates are accounted for prospectively in the period of change.

NOTE: Downwards revaluation losses under IAS 16 and the Code are accounted for firstly in the revaluation reserve, up to the available balance for the applicable asset in that reserve, with any excess above this amount being taken to surplus and deficit on provision of services (revenue expenses). In effect this is taking the asset back to the level of its depreciated historical cost by eliminating the full balance in the revaluation reserve with any excess being taken to Surplus and Deficit on Provision of Services.

5. Reversals

5.1 **Reversals of Asset Valuation Losses taken to Surplus and Deficit on Provision of Services**

In the case of an asset that was previously revalued downwards with an adjustment being taken through Surplus and Deficit on Provision of Services, any subsequent revaluation gain for that asset is subject to the following under the Code (paragraph 4.1.2.35).

5.2 A revaluation gain shall be used to reverse a previous revaluation decrease recognised in Surplus or Deficit on the Provision of Services on the same asset. In the same way as the treatment of a reversal of a previous impairment loss (see section 4.7 of the Code), the reversal of a revaluation decrease previously recognised in Surplus or Deficit on the Provision of Services shall not exceed the increase that would reinstate the carrying amount that would have been determined (net of amortisation or depreciation) had no revaluation decrease been recognised for the asset in prior years. Any excess above the carrying amount that would have been determined (net of amortisation or depreciation) had no revaluation decrease been recognised for the asset in prior years shall be treated as a revaluation gain and credited to the Revaluation Reserve.

5.3 In graphical terms this adjustment works as follows (figure 1 below):

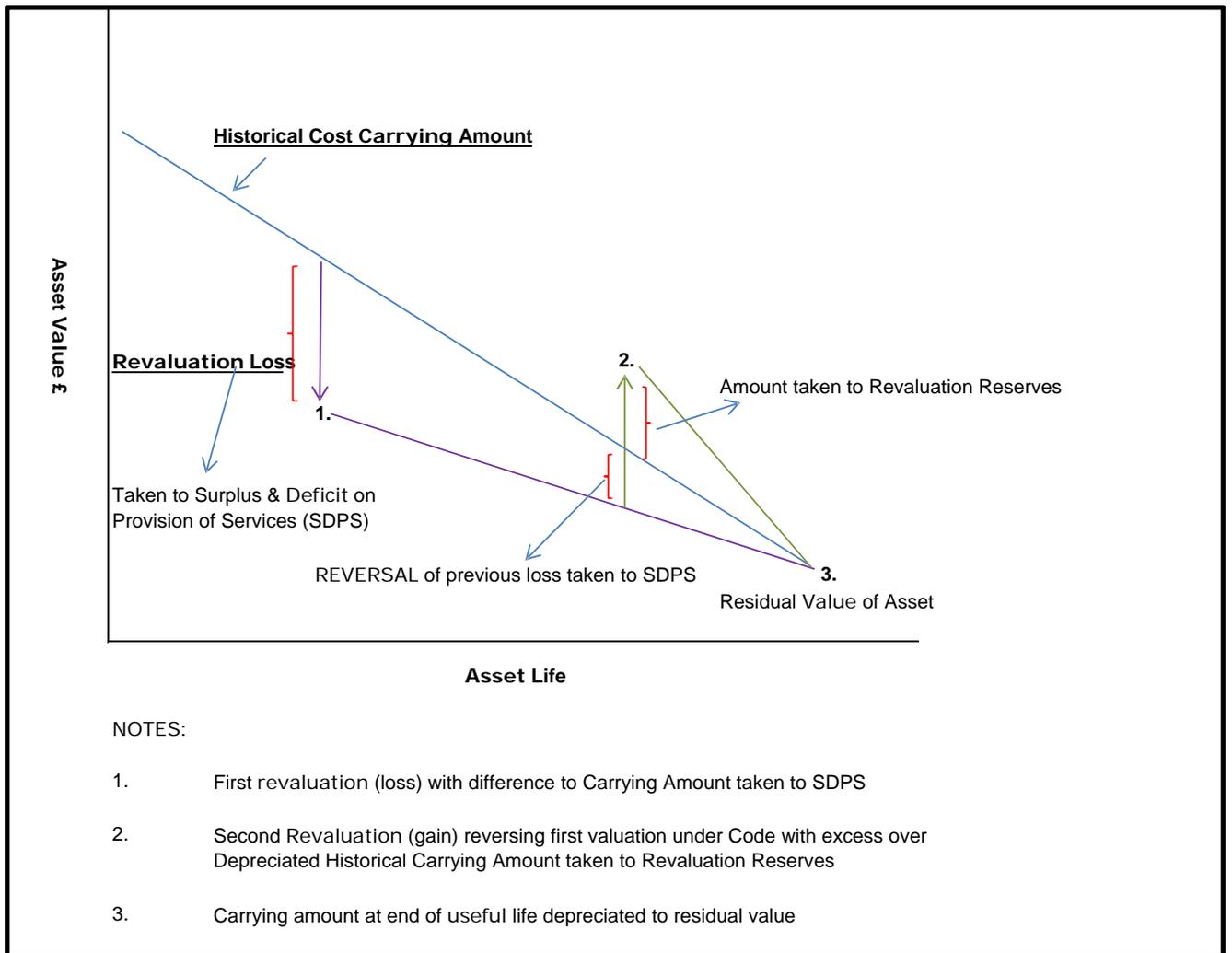


Figure 1: Revaluations Accounting Treatment