4.1 Property, Plant and Equipment

10.1.2.30 Transactions in relation to assets classified as held for sale and sold (i.e. derecognised) during 2009/10 will need to be restated in line with the Code. The required entries to restate the 2009/10 transactions are included in steps 4 and 5 of the transition section of non-current assets held for sale and discontinued operations.

It is expected that assets that meet the requirements in the Code to be classified as held for sale would have been classified as surplus assets under the SORP. The transition arrangements for such assets are included in the transition arrangements for section 4.9 of the Code. Where this was not the case, authorities will need to identify the appropriate accounting treatment.

10.1.2.31 The Code (following IFRS 1) requires local authorities to classify and account for property plant and equipment in their opening IFRS balance sheet (1 April 2009) in accordance with chapter 4 section 1 of the Code (see also IAS 16 and IPSAS 17). The Code requires the historical cost to be carried forward from the existing UK GAAP accounting in the SORP (mainly in relation to infrastructure assets, community assets and assets under construction).

Where assets are carried at historical cost (infrastructure assets, community assets and assets under construction),the carrying amount at 1 April 2009 under the Code will be the same as the carrying amount at 31 March 2009 under the SORP. As these assets are not revalued, the carrying amount at 31 March 2010 under the Code are also expected to be the same as under the SORP at that date. No transition adjustments will be required for these assets unless the residual value under the Code is materially different (see 10.1.2.34), or the asset was depreciated using renewals accounting (see 10.1.2.35). This treatment is also expected to apply to vehicles, plant and equipment that are carried at historical cost as a proxy for fair value.

Where assets are carried at current cost (other classes of assets), information regarding the historical cost of the asset is used to determine when impairments and revaluation losses are charged to Surplus and Deficit rather than to the Revaluation Reserve (i.e. when the current cost falls below depreciated historical cost). The historical cost of the asset is also used to determine the adjustment between the revaluation reserve and capital adjustment account in respect of depreciation based on an unrealised gain. Historical cost under the Code will be the same as under the SORP.

10.1.2.32 The Code introduces the concept of fair value as a basis of valuation for certain classes of assets. However, there is unlikely to be transition issues with regard to the use of fair value because fair value has been interpreted under the property, plant and equipment section of the Code as ‘the amount that would be paid for the asset in its existing use. This requirement is met by providing the existing use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards’, which is the same basis of valuation used under the SORP (ie EUV). In addition the valuation methods under the Code of; existing use value-social housing (EUV-SH) for council dwellings and depreciated replacement cost (DRC) for specialist properties where there is no market-based evidence of fair value, will be same as under the SORP.

Because the valuation bases used in the Code are the same as those used in the SORP, there will be no transition adjustments in respect of valuations required for most assets. However, this may not be the case where assets are reclassified on transition to the Code. The type of assets that are most likely to require transition adjustments are assets that were classified as surplus or as investment property under the SORP (and therefore carried at market value) but that do not meet the criteria under the Code to be classified as either held for sale or investment property. Such assets will need to be revalued using the relevant valuation basis *for the class of asset (which most commonly will be existing use value) under the Code. The transition arrangements are included in the transition arrangements for section 4.4 (investment property) and section 4.9 (surplus assets) of the Code.*

10.1.2.33 The requirement for component accounting as set out in chapter 4 section 1 of the Code, shall be applicable from 1 April 2010 and therefore will have no impact on transition.

Authorities are not required to account for separate components of an asset (unless the components were accounted for separately under the SORP) as part of the transition arrangements. Similarly, the requirement to derecognise part of an asset that is replaced does not apply on transition (unless this treatment was followed under the SORP). Instead, authorities will need to start accounting for separate components of an asset (where these are significant, and have either a different depreciation basis or a different useful life) and derecognising replaced components prospectively from 1 April 2010. The effect of this requirement is that authorities will need to consider accounting for separate components when assets are:

a) acquired on or after 1 April 2010;
b) enhanced (including replacing components) on or after 1 April 2010; or
c) revalued on or after 1 April 2010.

Whilst component accounting will have no impact on transition, authorities will need to consider the implications for managing their 2010/11 capital programmes, and for instructing valuers in relation to revaluations to be carried out during 2010/11. Component accounting will need to be considered for all classes of asset, including council housing. LAAP Bulletin 86 and Module 4, Section D of the Code Guidance Notes provide guidance on component accounting for property assets. DCLG are expected to publish revised Stock Valuation Guidance covering the revaluation of HRA assets in England shortly.

10.1.2.34 The Code requires residual values to be based on current prices at the balance sheet date. This may require the restatement of the residual values and depreciation charges of assets carried at historical cost. However, it is anticipated that for authorities, the residual values of assets carried at historical cost (i.e. community and infrastructure assets) will not be material.

Assets that are carried at historical cost under the Code (i.e. community and infrastructure assets) are generally held in perpetuity. As such, the residual value of the asset is likely to be insignificant. In addition, some community assets will have an unlimited useful life (e.g. land) and therefore not be subject to depreciation. As a result of these circumstances, the requirement in the Code that residual values are to be based on current prices at the balance sheet date is not expected to result in material differences in the depreciation (and hence the carrying amount) of assets carried at historical cost.

Where assets are carried at current cost (i.e. at fair value), the residual value will have been assessed periodically as part of the revaluation exercise under the SORP. As such, it is expected that the residual value at the last valuation will (normally) not be materially different from that at the balance sheet date.

Where the Code requirement to base the residual value of an asset on current prices at the balance sheet date does not result in a material difference, no transition adjustments will be required in respect of revisions to the residual value.

Further guidance on residual values can be found in paragraphs D27 – D30 of Module 4 of the Code Guidance Notes.

In those cases where the difference is material, authorities will need to restate the carrying amount of the asset in the 1 April 2009 Balance Sheet (to reflect the *difference between the depreciation charged under the SORP and the depreciation that would have been charged under the Code). Where the asset had previously been revalued, the transfer between the Revaluation Reserve and the Capital Adjustment Account (for the depreciation on the revalued portion of the carrying amount) will also need to be restated. The entries required are as follows:*

> *Dr / Cr Property, Plant and Equipment*
> *Cr / Dr Capital Adjustment Account*
>
> *With the amount required to restate the carrying amount of the asset at 1 April 2009*
>
> *Dr / Cr Capital Adjustment Account*
> *Cr / Dr Revaluation Reserve*
>
> *With the amount required to restate the transfer in relation to depreciation on the revalued portion of the carrying amount*

A worked example is shown in Example A in the spreadsheet.

Assuming the value of the asset was materially correct as at 31 March 2007, the arrangements for implementing the Revaluation Reserve as at 1 April 2007 will have automatically dealt with any imbalances prior to that date. Adjustments will therefore only be required where the difference in the depreciation charges in 2007/08 and 2008/09 would lead to a materially different carrying value for the asset. This automatic correction is shown in Example B in the spreadsheet.

Authorities should note that the role of the residual value has not changed under the Code (it is still used in calculating depreciation), only the basis of measurement. Residual values need not be recorded where they are not relevant.

10.1.2.35 The Code does not permit renewals accounting. The option under the SORP of using renewals accounting as a method of estimating depreciation for infrastructure assets is not widely used by authorities and where it is used previous records detailing the charges may not be readily available. A prospective approach to transition shall therefore be applied with effect from 1 April 2009.

As the Code requires a prospective approach to be adopted from 1 April 2009, the 1 April 2009 balance sheet will not need adjusting in respect of renewals accounting.

<u>Reversal of Revaluation Gains</u>

The 1 April 2009 balance sheet may need to be restated where a revaluation loss had been charged to the Income and Expenditure Account and a subsequent revaluation gain on the same assets had been recognised. Under the SORP, the revaluation gain may have been taken to the revaluation reserve, whereas under the Code the gain would have reversed the loss in the Income and Expenditure Account. In such circumstances, the 1 April 2009 balance sheet will need to be restated.

Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009

10.1.2.36 Where a revaluation gain has been recognised in the Revaluation Reserve prior to 1 April 2009 on an asset with a previous revaluation loss recognised in the Income and Expenditure account (under the SORP), an adjustment shall be made between the Revaluation Reserve and the Capital Adjustment Account.

Under the SORP, the revaluation gain may have been credited to the Revaluation Reserve. Under the Code, the gain would have been credited to Surplus or Deficit *(the equivalent of the Income and Expenditure Account), allowing for any depreciation that would have been charged had no revaluation decrease been recognised for the asset in prior years.*

Had the Code been in effect in previous years, the gain (subject to the limit discussed above) would have been credited to Surplus or Deficit, and then transferred under statutory provisions to the Capital Adjustment Account. The entries required to restate the 1 April 2009 balance sheet are therefore as follows:

Dr Revaluation Reserve *Cr Capital Adjustment Account* *With the amount of the revaluation gain that reversed a previous revaluation loss, adjusted for depreciation*

Authorities should note that because the Revaluation Reserve was only introduced as at 1 April 2007, only revaluation gains (and losses) during 2007/08 and 2008/09 need to be considered. As a revaluation gain in 2007/08 would require a revaluation loss to have been recognised earlier in the same year, in practice only revaluation gains during 2008/09 are likely to need to be considered.

Restate Comparative Figures for 2009/10

10.1.2.37 Transactions in relation to renewals accounting shall be reversed and replaced with a depreciation charge based on the depreciation policy of the authority.

Authorities that have applied renewals accounting in 2009/10 will need to reverse the entries made under the SORP, and replace them with the entries required by the Code. Depreciation would have been charged in line with the level of expenditure incurred to maintain the asset in its current condition; this might be more or less than the level of depreciation required by the application of a depreciation policy based on the asset life. Where the level of depreciation charged under the SORP is materially different to the amount that would be charged under the Code, the 2009/10 accounts should be restated by adjusting the accounts for the difference in depreciation:

Dr / Cr Service Revenue Accounts *Cr / Dr Property, Plant and Equipment* *With the difference between the depreciation charged under the SORP and the depreciation that would be charged under the Code* *Dr / Cr Capital Adjustment Account* *Cr / Dr General Fund (in the Movement in Reserves Statement)* *With the statutory reversal of the amendment to the depreciation charge*

Authorities may also need to review the expenditure capitalised under the policy of renewals accounting; where this does not meet the definition of capital expenditure under the Code, the amount will need to be restated:

Dr Service Revenue Accounts *Cr Property, Plant and Equipment* *With the amount of expenditure that does not meet the definition of capital expenditure*

This situation is expected to be uncommon.

10.1.2.38 Depreciation will need to be restated in the event that an asset's residual value carried at historical cost is different from the residual value based on current prices.

The most common scenario would be that the residual value based on current prices at the balance sheet date was higher than the residual value estimated when the asset was acquired or constructed. However, it is possible that the residual value will have reduced. In either case, depreciation should be recalculated so as to reduce the carrying amount of the asset as at 1 April 2009 (which may have been adjusted under 10.1.2.34 above) to its residual value over the useful life of the asset. Depreciation charged in 2009/10, and any transfer from the Revaluation Reserve, will need to be restated. The entries required are:

Dr / Cr Property, Plant and Equipment
Cr / Dr Service Revenue Accounts

With the amount required to adjust the depreciation charge in 2009/10 to reflect the revised residual value

Dr / Cr General Fund (in the Movement in Reserves Statement)
Cr / Dr Capital Adjustment Account

With the statutory reversal of the amendment to the depreciation charge

Dr / Cr Capital Adjustment Account
Cr / Dr Revaluation Reserve

With the amount required to restate the transfer in relation to depreciation on the revalued portion of the carrying amount

A worked example is shown in Example A in the spreadsheet.

In calculating the revised depreciation charge, the following paragraph of the Code may be relevant:

> *4.1.2.39 The only other ground for not charging depreciation is when the residual value of an asset is equal or greater than the asset's carrying amount. Repairs and maintenance do not remove the need to depreciate an asset.*

10.1.2.39 Where an impairment loss in 2009/10 (ie general fall in prices) is reclassified as a revaluation loss, the loss recognised in General Fund or HRA shall be reclassified as a revaluation loss. Where a revaluation gain has been recognised in the Revaluation Reserve in 2009/10 on an asset with a previous revaluation loss recognised in the Income and Expenditure account (under the SORP), an adjustment shall be made between the Revaluation Reserve and Surplus or Deficit on provision of services. This adjustment shall be reversed to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

Where a loss charged to Surplus or Deficit is reclassified as a revaluation loss, the loss shall be presented in the notes to the accounts for the 2009/10 comparative year as a revaluation loss. Authorities may also wish to reclassify the loss where this has been charged to the Income and Expenditure account (in line with BVACOP).

Where the reversal of a revaluation loss was adjusted by restating the 1 April 2009 balance sheet, no further adjustments would be required in most cases as the carrying amount of the assets would not change, and therefore any depreciation charge would be correct. However, if there was a subsequent revaluation or impairment loss in 2009/10, it is possible that the restatement of the Revaluation

Reserve as at 1 April 2009 would have the effect of requiring an increased charge to Surplus or Deficit in 2009/10, as the amount that could be charged to the Revaluation Reserve would decrease. The entries required in these circumstances are:

Dr Service Revenue Accounts
Cr Revaluation Reserve

With the loss previously charged to the Revaluation Reserve for which no balance exists on the reserve

Dr Capital Adjustment Account
Cr General Fund (in the Movement in Reserves Statement)

With the statutory reversal of the increased loss charged to Surplus or deficit

Where a revaluation gain occurs in 2009/10 in respect of an asset with a previous revaluation loss that had been charged to the Income and Expenditure Account, the gain under the SORP may have been credited to the Revaluation Reserve (rather than Surplus or Deficit as required by the Code). In such cases, the following entries will be required:

Dr Revaluation Reserve
Cr Service Revenue Accounts

With the amount of the revaluation gain that reversed a previous revaluation loss, adjusted for depreciation

Dr General Fund (in the Movement in Reserves Statement)
Cr Capital Adjustment Account

With the statutory reversal of the revaluation adjustment