SSAP 17, Property, Plant and Equipment

Background

SSAP 17 came into effect for financial statements covering periods beginning on or after 1 January 2001.

Questions and answers on SSAP 17 appear below.

Contents

Disclaimer

Please note that this document is intended for general guidance only and is subject to the Hong Kong Society of Accountants (HKSA) Staff Policy on Handling Technical Queries, posted on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/policy/techqs.pdf. Accordingly, the material in this document represents the personal views of the authors and does not constitute an authoritative pronouncement on behalf of the HKSA or the HKSA's Financial Accounting Standards Committee. The HKSA and the authors do not accept any responsibility whatsoever for any accounting treatment and/or the auditing or professional procedures applied on the basis of this document. The contents of this document, which is subject to change from time to time, shall not be permissible as evidence in connection with any investigation or disciplinary proceedings of the HKSA or other legal proceedings.

Feedback welcomed

We welcome your comments and feedback. Comments and suggestions on the material in this document should be addressed to Mr. Simon Riley, Deputy Director – Accounting, Hong Kong Society of Accountants, e-mail: commentletters@hksa.org.hk.

Relevant links

SSAP 17........http://www.hksa.org.hk/professionaltechnical/pronouncements/handbook/volume2a/2_117.htm

Summary of SSAP 17...........http://www.hksa.org.hk/professionaltechnical/accounting/standards/ssap17.pdf

HKSA Financial Reporting home page ....http://www.hksa.org.hk/professionaltechnical/accounting/

Reference materials page ....http://www.hksa.org.hk/professionaltechnical/accounting/rm

SSAP 17.31-1 Requirement for a professionally qualified valuer's appraisal

Q: Is it necessary for an entity to obtain a professionally qualified valuer's appraisal of fair value of property, plant and equipment carried at revalued amount under SSAP 17?

A: SSAP 17 paragraph 31 requires that "… revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date".

SSAP 17 paragraph 32 suggests that the fair value of land and buildings is usually the open market value determined by an appraisal normally undertaken by professionally qualified valuers. As to whether the involvement of a professionally qualified valuer is required under SSAP 17 in each and every case is primarily a matter of judgement for the financial statement preparer and auditor. For example, the guidance in SSAP 17 paragraph 34 suggests the necessity for a professional valuation at every balance sheet date may depend on the materiality of the class of asset concerned and the volatility of open market values. When a class of property, plant and equipment is less material and/or considered not to be subject to open market value volatility, it may be possible to obtain a professional valuation once in every two or three years. SSAP 13 contains specific valuation requirements in respect of investment property carried at open market value.

SSAP 17.67-1 Gain or loss on the disposal of a revalued asset

Q: A tangible non-current asset, which has been revalued under SSAP 17, has been disposed of during the year at a gain on cost, thus realising in part, if not in full, the revaluation surplus attributed to that asset. Should the gain on disposal of the fixed asset, which is represented by the realised revaluation surplus, be recognised in the income statement?

A: SSAP 17 (2001), paragraph 67 states that, "Gains or losses arising from the retirement or disposal of an item of property, plant and equipment should be determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement." SSAP 17.67 is identical to the corresponding requirement in IAS 16.56.

SSAP 17.41, however, states "the revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the enterprise; in such a case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. The transfer from revaluation surplus to retained earnings is not made through the income statement". SSAP 17.41 is identical to the corresponding requirement in IAS 16.39.

Paragraph 41 might be interpreted in the following manner:

- ✓ The first sentence permits, but does not require, a revaluation surplus to be transferred directly to retained earnings when the surplus is realised - that is, the gain that is represented by the realisation of revaluation surplus need not be recognised through the income statement.

  Implicit in this sentence - by expressly <u>permitting</u> the transfer directly to retained earnings - is that this is not the course of action that might be contemplated initially … that is, the treatment otherwise contemplated would have been to recognise the realised revaluation surplus through the income statement. In the absence of the first sentence to paragraph 41, it might be argued that recognition of the gain through the income statement would be <u>required</u>.

- ✓ The final sentence should be interpreted in the context of the first sentence - that is, when the option of transfer directly to retained earnings is exercised, the transfer is not effected through the income statement. The last sentence does not act to prohibit the recognition of the gain through the income statement if the option to transfer directly to retained earnings, as permitted by the first sentence, is not taken.

But for the overriding (bold type-face) requirement in SSAP 17.67, it could be argued that the effect of SSAP 17.41 would be to permit a free choice as whether to recognise, as a gain in the income statement, a realised revaluation surplus.

Conclusion

SSAP 17 requires that a revaluation surplus realised on the disposal of a fixed asset be transferred from revaluation reserve directly to retained earnings and not recognised as a gain in the income statement.

Application of this requirement is shown in the following example.

Example - Disposal of revalued assets

On 1 January 20X1 a company acquires an asset for $1,000. The asset has an economic life of ten years and is depreciated on a straight-line basis. The residual value is assumed to be $nil. At 31 December 20X4 the asset is valued at $1,200. The company accounts for the revaluation with $600 being credited to the revaluation reserve. At 31 December 20X4 the economic life of the asset is considered to be the remainder of its original life, i.e. six years, and its residual value is still considered to be $nil. In the year ended 31 December 20X5 and later years depreciation charged to the income statement is $200 p.a.

The asset is sold for $1,300 on 31 December 20X6. The annual depreciation charge for 20X5 and 20X6 is $200 and the company has made an annual transfer from revaluation reserve to realised reserves of $100, which represents the annual depreciation on the revaluation surplus. For the purposes of this example taxation has been ignored. The carrying value and the depreciated historical cost of the asset at the date of sale are as follows:

	Carrying value $	Historical cost $
Cost or valuation		
At 31 December 20X6	1,200	1,000
Depreciation		
At 1 January 20X6	200	500
Charge for year	200	100
At 31 December 20X6	400	600
Net book value at 31 December 20X6	800	400

The gain on disposal based on the balance sheet carrying value is $500; based on depreciated original cost it is $900 as shown below.

	method (i)	method (ii)
Income statement	$	$
Profit on trading activities	1,000	1,000
Gain on sale of revalued asset	500	900
Retained profit for the financial year	1,500	1,900
Retained profits		
Opening balance	6,000	6,000
Retained profit for the financial year	1,500	1,900
Transfer from revaluation reserve – realised on sale	400	–
Transfer from revaluation reserve – depreciation	100	100
Closing balance	8,000	8,000
Revaluation reserve		
Opening balance	500	500
Transfer to income statement – realised on sale	–	(400)
Transfer to retained profits – realised on sale	(400)	–
Transfer to retained profits – depreciation	(100)	(100)
Closing balance	–	–

Method (i) is the approach required by SSAP 17.67.