STATEMENT OF ALTERNATIVE TREATMENT (SoAT)

Revaluation Option for the Property, Plant & Equipment for entities adopting the Sri Lanka Accounting Standard for SMEs

The Statement of Alternative Treatment (SoAT) on Revaluation Option for the Property, Plant & Equipment (PPE) for entities adopting the Sri Lanka Accounting Standard for Small and Medium sized Entities (SLFRS for SMEs) was approved by the Council of the Institute of Chartered Accountants of Sri Lanka on 13th August 2014.

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Although the provisions for this Statement of Alternative Treatment (SoAT) are not mandatory, entities falling within their scope are encouraged to comply with the recommendations set out in this SoAT.

Introduction:

Sri Lanka Accounting Standard for Small and Medium Sized Entities (SLFRS for SMEs) was issued by the Council of CA Sri Lanka in 2011. This Standard is a self-contained standard designed to meet the needs and capabilities of smaller businesses.

The SLFRS for SMEs currently prohibits the revaluation of property, plant and equipment (PPE). Instead, all items of PPE must be measured at cost less any accumulated depreciation and any accumulated impairment losses (Section 17.15 of SLFRS for SMEs). In full SLFRSs, LKAS 16 Property, Plant and Equipment allows entities to choose the revaluation model.

When drafting this Statement of Alternative Treatment, the Institute of Chartered Accountants of Sri Lanka has considered several requests of the corporate community on allowing the revaluation as an option on measurement after initial recognition similar to full SLFRS.

Objective:

1. The objective of this SoAT is to prescribe for the entities adopting the SLFRS for SMEs Standard an allowed alternative treatment for the **Section 17.15 of** SLFRS for SMEs **on measurement after initial recognition for Property, Plant & Equipment (PPE).**

Scope:

2. This SoAT may be applied in the **measurement after initial recognition of Property, Plant & Equipment**.

Measurement after Initial Recognition:

3. An entity shall measure all items of property, plant and equipment after initial recognition at cost model (Section 17.15 of SLFRS for SMEs) or revaluation model in paragraph 4.

4. After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a **revalued amount**, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. 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.

5 The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers. The fair value of items of plant and equipment is usually their market value determined by appraisal.

6 If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a

continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.

7 The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

8 When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:

(a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to determine its depreciated replacement cost.

(b) 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 12 and 13.

9 If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

10 A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

(a) land;

(b) land and buildings;

(c) machinery;

(d) ships;

(e) aircraft;

(f) motor vehicles;

(g) furniture and fixtures; and

(h) office equipment.

11 The 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. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

12 If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

13 If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

14 The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.

Transfers from revaluation surplus to retained earnings are not made through profit or loss.

15 The effects of taxes on income, if any, resulting from the revaluation of property, plant and equipment are recognised and disclosed in accordance with LKAS 12 Income Taxes.

Income Taxes

16 SLFRS for SME permit certain assets to be carried at fair value or to be revalued. In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

(a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

(b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets.

Reversal of Impairment

17 A reversal of an impairment loss on a revalued asset is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

Disclosures

18 A reconciliation of the carrying amount at the beginning and end of the period of PPE shall separately shows the increases or decreases resulting from revaluations and from impairment losses recognised or reversed in other comprehensive income.

19 If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed:

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) the methods and significant assumptions applied in estimating the items' fair values;

(d) the extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques;

(e) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and

(f) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

20 An entity shall disclose the following for each class of assets:

(a) the amount of impairment losses on revalued assets recognised in other comprehensive income during the period.

(b) the amount of reversals of impairment losses on revalued assets recognised in other comprehensive income during the period.

Transition

21. Where an entity has elected to follow the revaluation model as specified in paragraph 3 of this SoAT, the entity shall account for the adjustments if any, as a result of that change in accounting policy, prospectively.

Effective Date

22 An entity shall apply this SoAT in its annual financial statements for periods beginning on or after 01 January 2014.