Accounting Standards Board February 1999 FRS 15

15

Tangible Fixed Assets

Financial Reporting Standard

Accounting Standards Board

Financial Reporting Standard 15 'Tangible Fixed Assets' is issued by the Accounting Standards Board in respect of its application in the United Kingdom and by the Institute of Chartered Accountants in Ireland in respect of its application in the Republic of Ireland.

15

FINANCIAL REPORTING

STANDARD

TANGIBLE

FIXED ASSETS

ACCOUNTING
STANDARDS
BOARD

Financial Reporting Standard 15 is set out in paragraphs 1–110.

The Statement of Standard Accounting Practice, which comprises the paragraphs set in bold type, should be read in the context of the Objective as stated in paragraph 1 and the definitions set out in paragraph 2 and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.

The explanatory paragraphs contained in the FRS shall be regarded as part of the Statement of Standard Accounting Practice insofar as they assist in interpreting that statement.

Appendix IV 'The development of the FRS' reviews considerations and arguments that were thought significant by members of the Board in reaching the conclusions on the FRS.

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SUMMARY

General

a Financial Reporting Standard 15 'Tangible Fixed Assets' sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties. Investment properties continue to be accounted for in accordance with SSAP 19 'Accounting for investment properties', but are being considered further in the light of other Board projects and the international project on investment properties.

b The FRS codifies much of existing accounting practice. Its objective is to ensure that tangible fixed assets are accounted for on a consistent basis and, where a policy of revaluation is adopted, that revaluations are kept up-to-date.

Initial measurement

c Whether acquired or self-constructed, a tangible fixed asset should initially be measured at its cost. Only costs that are directly attributable to bringing the asset into working condition for its intended use should be included. Such costs should be capitalised only for the period in which the activities that are necessary to get the asset ready for use are in progress.

d The capitalisation of finance costs, including interest, is optional. However, if an entity adopts such a policy then it should be applied consistently. All finance costs that are directly attributable to the construction of a tangible fixed asset should be capitalised as part of the cost of that asset, subject to the proviso that the total amount of finance costs capitalised during a period should not exceed the amount of finance costs incurred during the period. The FRS also sets limits on the period of capitalisation and specifies certain disclosure requirements.

e If the amount recognised when a tangible fixed asset is acquired or constructed exceeds its recoverable amount, it should be written down to recoverable amount. However, on initial recognition the asset needs to be reviewed for impairment only if there is an indication of impairment, in accordance with FRS 11 'Impairment of Fixed Assets and Goodwill'.

f Subsequent expenditure undertaken to ensure that the asset maintains its previously assessed standard of performance, for example routine repairs and maintenance expenditure, should be recognised in the profit and loss account as it is incurred. Without such expenditure the depreciation expense would be increased because the useful economic life or residual value of the asset would be reduced. However, subsequent expenditure should be capitalised in three circumstances, where the expenditure:

(i) enhances the economic benefits of the asset in excess of its previously assessed standard of performance; or

(ii) replaces or restores a component of the asset that has been treated separately for depreciation purposes and depreciated over its individual useful economic life; or

(iii) relates to a major inspection or overhaul that restores the economic benefits of the asset that have been consumed by the entity and have already been reflected in depreciation.

Valuation

g An entity has the option of revaluing its tangible fixed assets. However, where such a policy is adopted it should be applied consistently to all tangible fixed assets of the same class.

h Where a tangible fixed asset is revalued its carrying amount should be its current value at the balance sheet date. Generally this requirement is achieved by performing a full valuation at least every five years and an interim valuation in year 3, with an interim valuation in the intervening years where it is likely that there has been a material change in value. Alternatively, for a portfolio of non-specialised properties, a full valuation may be performed on a rolling basis over a five-year cycle, together with an interim valuation on the remaining portfolio where it is likely that there has been a material change in value. For tangible fixed assets other than properties where there is an active second-hand market or appropriate indices, such that the entity's directors can establish the asset's value with reasonable reliability, an annual revaluation by the directors may be sufficient, without necessarily using the services of a qualified valuer.

i Where tangible fixed assets are revalued the following valuation bases for unimpaired assets should be used:

- non-specialised properties—existing use value,* with the addition of notional directly attributable acquisition costs, where material

- specialised properties—depreciated replacement cost

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* *As defined by the Royal Institution of Chartered Surveyors (RICS). These definitions are reproduced in Appendix I.*

- properties surplus to an entity's requirements—open market value,* after deducting expected directly attributable selling costs, where material

- tangible fixed assets other than properties—market value, or depreciated replacement cost where market value is not available.

j Revaluation gains are recognised in the statement of total recognised gains and losses except to the extent that they reverse revaluation losses on the same asset that were previously recognised in the profit and loss account, in which case they, too, should be recognised in the profit and loss account, after adjusting for subsequent depreciation.

k All revaluation losses that are caused by a clear consumption of economic benefits are recognised in the profit and loss account. Other revaluation losses are recognised in the statement of total recognised gains and losses until the carrying amount of the asset falls below depreciated historical cost. Revaluation losses below depreciated historical cost are recognised in the profit and loss account, except where it can be demonstrated that the recoverable amount of the asset is greater than its revalued amount, in which case the loss is recognised in the statement of total recognised gains and losses to the extent that the recoverable amount of the asset is greater than its revalued amount.

l Profits and losses on the disposal of tangible fixed assets are treated in accordance with FRS 3 'Reporting Financial Performance'—ie calculated as the difference between the net sale proceeds and the carrying amount and recorded in the profit and loss account in the period in which the disposal occurs.

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* *As defined by the Royal Institution of Chartered Surveyors (RICS). These definitions are reproduced in Appendix I.*

m Where an entity revalues its tangible fixed assets the FRS requires specific disclosures about the valuation.

Depreciation

n The fundamental objective of depreciation is to reflect in operating profit the cost of use of the tangible fixed assets (ie the amount of economic benefits consumed by the entity) in the period. Therefore, the depreciable amount (ie cost, or revalued amount, less residual value) of a tangible fixed asset should be recognised in the profit and loss account on a systematic basis that reflects as fairly as possible the pattern in which the asset's economic benefits are consumed by the entity, over its useful economic life.

o Where the tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life.

p Subsequent expenditure on a tangible fixed asset that maintains or enhances the previously assessed standard of performance of the asset does not negate the need to charge depreciation, as, other than non-depreciable land, all tangible fixed assets have finite lives. However, where the remaining useful economic life of a tangible fixed asset is estimated to be greater than 50 years or where the depreciation charge is immaterial owing to a long useful economic life or high residual value, then, to ensure that the carrying amount can be supported, the tangible fixed asset should be subjected to impairment reviews at the end of each reporting period, performed in accordance with FRS 11.

q The useful economic life of a tangible fixed asset and its residual value (based on the price level that existed when the asset was purchased or last revalued) where material, should be reviewed at the end of each reporting period. If expectations are significantly different from previous estimates, the change should be accounted for prospectively over the tangible fixed asset's remaining useful economic life, except to the extent that the asset has been impaired at the balance sheet date.

r The FRS requires specific disclosures about the depreciation policies adopted by an entity and changes in those policies.

FINANCIAL REPORTING STANDARD 15

Objective

1 The objective of this FRS is to ensure that:

(a) consistent principles are applied to the initial measurement of tangible fixed assets.

(b) where an entity chooses to revalue tangible fixed assets the valuation is performed on a consistent basis and kept up-to-date and gains and losses on revaluation are recognised on a consistent basis.

(c) depreciation of tangible fixed assets is calculated in a consistent manner and recognised as the economic benefits are consumed over the assets' useful economic lives.

(d) sufficient information is disclosed in the financial statements to enable users to understand the impact of the entity's accounting policies regarding initial measurement, valuation and depreciation of tangible fixed assets on the financial position and performance of the entity.

Definitions

2 The following definitions shall apply in the FRS and in particular in the Statement of Standard Accounting Practice set out **in bold type**.

Class of tangible fixed assets:-

A category of tangible fixed assets having a similar nature, function or use in the business of the entity.

Current value:-

The current value of a tangible fixed asset to the business is the lower of replacement cost and recoverable amount.

Depreciable amount:-

The cost of a tangible fixed asset (or, where an asset is revalued, the revalued amount) less its residual value.

Depreciated replacement cost (of property):-

Has the same meaning as in the *Appraisal and Valuation Manual* published by the Royal Institution of Chartered Surveyors (RICS). The definition is reproduced in Appendix I.

Depreciated replacement cost (of tangible fixed assets other than property):-

The cost of replacing an existing tangible fixed asset with an identical or substantially similar new asset having a similar production or service capacity, from which appropriate deductions are made to reflect the value attributable to the remaining portion of the total useful economic life of the asset and the residual value at the end of the asset's useful economic life.

> Costs directly attributable to bringing the tangible fixed asset into working condition for its intended use, such as costs of transport, installation, commissioning, consultants' fees, non-recoverable taxes and duties, are included in depreciated replacement cost. The deductions from gross replacement cost should take into account the age and condition of the asset, economic and functional obsolescence, and environmental and other relevant factors.

Depreciation:-

The measure of the cost or revalued amount of the economic benefits of the tangible fixed asset that have been consumed during the period.

Consumption includes the wearing out, using up or other reduction in the useful economic life of a tangible fixed asset whether arising from use, effluxion of time or obsolescence through either changes in technology or demand for the goods and services produced by the asset.

Existing use value:-

Has the same meaning as in the *Appraisal and Valuation Manual* published by the RICS. The definition is reproduced in Appendix I.

Finance costs:-

The difference between the net proceeds of an instrument and the total amount of payments (or other transfers of economic benefits) that the issuer may be required to make in respect of the instrument.

The definition set out above is taken from FRS 4 'Capital Instruments'. Finance costs include:

(a) interest on bank overdrafts and short-term and long-term debt;

(b) amortisation of discounts or premiums relating to debt; and

(c) amortisation of ancillary costs incurred in connection with the arrangement of debt.

Impairment:-

A reduction in the recoverable amount of a tangible fixed asset below its carrying amount.

The definition set out above is taken from FRS 11 'Impairment of Fixed Assets and Goodwill'.

Non-specialised properties:-

Has the same meaning as in the *Appraisal and Valuation Manual* published by the RICS. The definition is reproduced in Appendix I.

Open market value:-

Has the same meaning as in the *Appraisal and Valuation Manual* published by the RICS. The definition is reproduced in Appendix I.

Qualified (internal or external) valuer:-

A person conducting the valuation who holds a recognised and relevant professional qualification and having recent post-qualification experience, and sufficient knowledge of the state of the market, in the location and category of the tangible fixed asset being valued. An internal valuer is a director, officer or employee of the entity. An external valuer is not an internal valuer and does not have a significant financial interest in the entity.

Recoverable amount:-

The higher of net realisable value and value in use.*

* *Refer to FRS 11 'Impairment of Fixed Assets and Goodwill' for a definition of value in use and details about its calculation.*

Residual value:-

The net realisable value of an asset at the end of its useful economic life. Residual values are based on prices prevailing at the date of the acquisition (or revaluation) of the asset and do not take account of expected future price changes.

Specialised properties:-

Has the same meaning as in the *Appraisal and Valuation Manual* published by the RICS. The definition is reproduced in Appendix I.

Tangible fixed assets:-

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity's activities.

Useful economic life:-

The useful economic life of a tangible fixed asset is the period over which the entity expects to derive economic benefit from that asset.

Scope

3 **The FRS applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.**

4 **The requirements of the FRS apply to all tangible fixed assets, with the exception of investment properties as defined in SSAP 19 'Accounting for investment properties'.**

5 **Reporting entities applying the Financial Reporting Standard for Smaller Entities (FRSSE) currently applicable are exempt from the FRS.**

Initial measurement

Cost

6 **A tangible fixed asset should initially be measured at its cost.**

7 **Costs, but only those costs, that are directly attributable to bringing the asset into working condition for its intended use should be included in its measurement.**

8 The cost of a tangible fixed asset (whether acquired or self-constructed) comprises its purchase price (after deducting any trade discounts and rebates) and any costs directly attributable to bringing it into working condition for its intended use.

9 Directly attributable costs are:

(a) the labour costs of own employees (eg site workers, in-house architects and surveyors) arising directly from the construction, or acquisition, of the specific tangible fixed asset; and

(b) the incremental costs to the entity that would have been avoided only if the tangible fixed asset had not been constructed or acquired.

It follows that administration and other general overhead costs would be excluded from the cost of a tangible fixed asset. Employee costs not related to the specific asset (such as site selection activities) are not directly attributable costs.

10 Examples of directly attributable costs include:

- acquisition costs (such as stamp duty, import duties and non-refundable purchase taxes)
- the cost of site preparation and clearance
- initial delivery and handling costs
- installation costs
- professional fees (such as legal, architects' and engineers' fees)
- the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision under FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'. The fact that the prospect of such expenditures emerges only some time after the original capitalisation of the asset (eg because of legislative changes) does not preclude their capitalisation.

11 Abnormal costs (such as those relating to design errors, industrial disputes, idle capacity, wasted materials, labour or other resources and production delays) and costs such as operating losses that occur because a revenue activity has been suspended during the construction of a tangible fixed asset are not directly attributable to bringing the asset into working condition for its intended use.

12 **Capitalisation of directly attributable costs should cease when substantially all the activities that are necessary to get the tangible fixed asset ready for use are complete, even if the asset has not yet been brought into use.**

13 A tangible fixed asset is ready for use when its physical construction is complete.

14 The costs associated with a start-up or commissioning period should be included in the cost of the tangible fixed asset only where the asset is available for use but incapable of operating at normal levels without such a start-up or commissioning period.

15 A distinction can be made between:

(a) the commissioning period for plant, in which it is impossible for it to operate at normal levels because of, for example, the need to run in machinery, to test equipment and generally to ensure the proper functioning of the plant; and

(b) an initial operating period in which, although the plant is available for use and capable of running at normal levels, it is operated at below normal levels because demand has not yet built up.

16 The costs of an essential commissioning period are included as part of the cost of bringing the asset up to its normal operating potential, and therefore as part of its cost. However, there is no justification for regarding costs relating to other start-up periods, where the asset is available for use but not yet operating at normal levels, for example because of a lack of demand, as part of the cost of the asset. An example is the start-up period of a new hotel or bookshop, which could operate at normal levels almost immediately, but for which experience teaches that demand will build up slowly and full utilisation or sales levels will be achieved only over a period of several months.

17 **The initial carrying amount of tangible fixed assets received as gifts and donations by charities should be the current value of the assets at the date they are received.**

18 Donated assets are particularly common in the charity sector. Such organisations often receive tangible fixed assets that the entity cannot dispose of without external consent and other tangible fixed assets of particular historic, scientific or artistic importance. On occasion, such assets may present measurement difficulties where conventional valuation approaches lack sufficient reliability. In addition, even where valuation is practical, if significant costs are involved they may be onerous compared with the additional benefit derived by users of the accounts in assessing management's stewardship of the assets. Where it can be demonstrated that these factors are significant alternative approaches to the valuation of those tangible fixed assets may be appropriate, provided that adequate disclosure of the reason for the different treatment, and of the age, nature and scale of the assets is given in the notes to the accounts. A similar approach is acceptable on the first implementation of the FRS where, under previously permitted accounting policies, a charity holds tangible fixed assets that were not capitalised as required by the FRS and for which reliable estimates of cost or value are not available on a cost-benefit basis. Generally, these issues will be addressed in the relevant sector-specific guidance and Statements of Recommended Practice (SORPs).

Finance costs

19 Where an entity adopts a policy of capitalising finance costs, finance costs that are directly attributable to the construction of tangible fixed assets should be capitalised as part of the cost of those assets. The total amount of finance costs capitalised during a period should not exceed the total amount of finance costs incurred during that period.

20 An entity need not capitalise finance costs. However, if an entity adopts a policy of capitalisation of finance costs, then it should be applied consistently to all tangible fixed assets where finance costs fall to be capitalised in accordance with the above requirement.

21 Only finance costs that are directly attributable to the construction of a tangible fixed asset, or the financing of progress payments in respect of the construction of a tangible fixed asset by others for the entity, should be capitalised. Directly attributable finance costs are those that would have been avoided (for example by avoiding additional borrowings or by using the funds expended for the asset to repay existing borrowings) if there had been no expenditure on the asset. Finance costs are capitalised on a gross basis, ie before the deduction of any tax relief to which they give rise.

22 Where the entity has borrowed funds specifically for the purpose of financing the construction of a tangible fixed asset, the amount of finance costs capitalised is limited to the actual costs incurred on the borrowings during the period in respect of expenditures to date on the tangible fixed asset. Finance costs in respect of leased tangible fixed assets should be accounted for in accordance with SSAP 21 'Accounting for leases and hire purchase contracts'.

23 Where the funds used to finance the construction of a tangible fixed asset form part of the entity's general borrowings, the amount of finance costs capitalised is determined by applying a capitalisation rate to the expenditure on that asset. For this purpose the expenditure on the asset is the weighted average carrying amount of the asset during the period, including finance costs previously capitalised. The capitalisation rate used in an accounting period is based on the weighted average of rates applicable to the entity's general borrowings that are outstanding during the period. This excludes borrowings by the entity that are specifically for the purpose of constructing or acquiring other tangible fixed assets (eg obligations in respect of finance leases), or for other specific purposes, such as loans used to hedge foreign investments.

24 In determining the borrowings to be included in the weighted average, the objective is a reasonable measure of the finance costs that are directly attributable to the construction of the asset. Accordingly, judgement will be required to make a selection of borrowings that best accomplishes the objective. In some circumstances, it is appropriate to include all borrowings by the parent and its subsidiaries when computing a weighted average of the finance costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the finance costs applicable to its own borrowings.

25 **Where finance costs are capitalised, capitalisation should begin when:**

(a) finance costs are being incurred; and

(b) expenditures for the asset are being incurred; and

(c) activities that are necessary to get the asset ready for use are in progress.

26 The activities necessary to get the asset ready for use encompass more than its physical construction. They include technical and administrative work before construction begins, such as obtaining permits. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, finance costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, finance costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

27 **Capitalisation of finance costs should be suspended during extended periods in which active development is interrupted.**

28 Finance costs may be incurred during an extended period in which the activities necessary to get the asset ready for use are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

29 **Capitalisation of finance costs should cease when substantially all the activities that are necessary to get the tangible fixed asset ready for use are complete. When construction of a tangible fixed asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of finance costs relating to a part should cease when substantially all the activities that are necessary to get that part ready for use are completed.**

30 A business park comprising several buildings, each of which can be used individually, is an example of an asset of which parts are usable while construction continues on other parts. An example of an asset that needs to be completed before any part can be used is an industrial plant involving several processes that are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosures—finance costs

31 **Where a policy of capitalisation of finance costs is adopted, the financial statements should disclose:**

(a) the accounting policy adopted;

(b) the aggregate amount of finance costs included in the cost of tangible fixed assets;*

**This disclosure is required by companies legislation as follows:*
in Great Britain, the Companies Act 1985, Schedule 4, paragraph 26(3).
in Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, paragraph 26(3).
in the Republic of Ireland, the Companies (Amendment) Act 1986, Schedule, paragraph 14(3).

(c) the amount of finance costs capitalised during the period;

(d) the amount of finance costs recognised in the profit and loss account during the period; and

(e) the capitalisation rate used to determine the amount of finance costs capitalised during the period.

Recoverable amount

32 **If the amount recognised when a tangible fixed asset is acquired or constructed exceeds its recoverable amount, it should be written down to its recoverable amount.**

33 A tangible fixed asset needs to be reviewed for impairment on initial recognition only if there is some indication that impairment has occurred, as set out in FRS 11 'Impairment of Fixed Assets and Goodwill'. A tangible fixed asset that is impaired on initial recognition should be written down in accordance with FRS 11.

Subsequent expenditure

34 **Subsequent expenditure to ensure that the tangible fixed asset maintains its previously assessed standard of performance should be recognised in the profit and loss account as it is incurred.**

35 This type of expenditure is often referred to as 'repairs and maintenance' expenditure. An entity will assess the standard of performance of an asset (or a component of the asset) to determine its useful economic life and residual value. It will also assume that certain 'repairs and maintenance' expenditure will be carried out to maintain the standard of performance of the asset over its estimated useful economic life. Examples are the cost of servicing or the routine overhauling of plant and equipment and repainting a building structure. Without such expenditure the depreciation expense would be increased because the useful economic life or residual value of the asset would be reduced.

36 **Subsequent expenditure should be capitalised in three circumstances:**

(a) where the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance.

(b) where a component of the tangible fixed asset that has been treated separately for depreciation purposes and depreciated over its individual useful economic life, is replaced or restored.

(c) where the subsequent expenditure relates to a major inspection or overhaul of a tangible fixed asset that restores the economic benefits of the asset that have been consumed by the entity and have already been reflected in depreciation.

37 Subsequent expenditure on a tangible fixed asset is recognised as an addition to the asset to the extent that the expenditure improves the condition of the asset beyond its previously assessed standard of performance. Examples of subsequent expenditure that results in an enhancement of economic benefits include:

- modification of an item of plant to extend its useful economic life or increase its capacity

- upgrading machine parts to achieve a substantial improvement in the quality of output.

38 Some tangible fixed assets require, in addition to routine repairs and maintenance (which is treated in accordance with paragraph 34), substantial expenditure every few years for major refits or refurbishment or the replacement or restoration of major components. For example, a furnace may require relining every five years. In accordance with paragraph 83, for depreciation purposes an entity accounts separately for major components (eg the furnace lining) that have substantially different useful economic lives from the rest of the asset. In such a case, each component is depreciated over its individual useful economic life, so that the depreciation profile of the whole asset more accurately reflects the actual consumption of the asset's economic benefits. Subsequent expenditure incurred in replacing or renewing the component is accounted for as an addition to the tangible fixed asset and the carrying amount of the replaced component is removed from the balance sheet in accordance with paragraphs 72 and 73.

39 The same approach may also be applied to major inspections and overhauls of tangible fixed assets. For example, an aircraft may be required by law to be overhauled once every three years. Unless the overhaul is undertaken the aircraft cannot continue to be flown. The entity reflects the need to undertake the overhaul or inspection by depreciating an amount of the asset that is equivalent to the expected inspection or overhaul costs over the period until the next inspection or overhaul. In such a case, the cost of the inspection or overhaul is capitalised when incurred because it restores the economic benefits of the tangible fixed asset and the carrying amount representing the cost of the benefits consumed is removed from the balance sheet in accordance with paragraphs 72 and 73.

40 The accounting treatment for subsequent expenditure should reflect the circumstances that were taken into account on the initial recognition of the asset and the depreciation profile adopted (or subsequent revisions thereof). Therefore, when the carrying amount of the asset already takes into account a consumption of economic benefits, eg by depreciating components of the asset at a faster rate than the asset as a whole (or by a previous impairment of the asset or component), the subsequent expenditure to restore those economic benefits is capitalised. The decision whether to identify separate components or future expenditures on overhauls or inspections for depreciation over a shorter useful economic life than the rest of the tangible fixed asset is likely to reflect:

- whether the useful economic lives of the components are, or the period until the next inspection or overhaul is, substantially different from the useful economic life of the remainder of the asset;

- the degree of irregularity in the level of expenditures required to restate the component or asset in different accounting periods; and

- their materiality in the context of the financial statements.

41 Where it has been determined not to account for each tangible fixed asset as several different asset components or to depreciate part of the asset over a different timescale from the rest of the asset, the cost of replacing, restoring, overhauling or inspecting the asset or components of the asset is not capitalised, but instead is recognised in the profit and loss account as incurred in accordance with paragraph 34.

Valuation

42 **Tangible fixed assets should be revalued only where the entity adopts a policy of revaluation. Where such a policy is adopted then it should be applied to individual classes of tangible fixed assets (in accordance with paragraph 61), but need not be applied to all classes of tangible fixed assets held by the entity.**

Frequency

43 **Where a tangible fixed asset is subject to a policy of revaluation* its carrying amount should be its current value as at the balance sheet date.**

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* *The term 'revaluation' does not encompass either the write-down of the carrying amount of a tangible fixed asset held at historical cost for an impairment in accordance with FRS 11, or determination of the cost of an asset acquired as a result of a business combination stated at its fair value at the date of acquisition, in accordance with FRS 7 'Fair Values in Acquisition Accounting', or, for charities, the initial measurement at current value of a donated tangible fixed asset in accordance with paragraph 17.*

44 The FRS does not insist on annual revaluations, although the objective of a revaluation policy is to reflect current values as at the balance sheet date. Paragraphs 45-52 outline the procedures to be adopted in order to satisfy the requirements of paragraph 43, although more frequent valuations may be undertaken where appropriate. However, for cost/benefit reasons, the details specified in paragraphs 45-52 may not be appropriate for charities and other not-for-profit and public sector organisations adopting a revaluation policy, in which case alternative approaches may be acceptable. Generally, these approaches will be addressed in the relevant sector-specific guidance and SORPs.

45 Where properties are revalued the requirements of paragraph 43 will be met by a full valuation at least every five years and an interim valuation in year 3. Interim valuations in years 1, 2 and 4 should be carried out where it is likely that there has been a material change in value.

46 Alternatively, for portfolios of non-specialised properties, a full valuation may be performed on a rolling basis designed to cover all the properties over a five-year cycle, together with an interim valuation on the remaining four-fifths of the portfolio where it is likely that there has been a material change in value. This approach is appropriate only where the property portfolio held by the entity either:

(a) consists of a number of broadly similar properties whose characteristics are such that their values are likely to be affected by the same market factors; or

(b) can be divided on a continuing basis into five groups of a broadly similar spread.

47 A full valuation of a property normally involves, inter alia, the following:

(a) detailed inspection of the interior and exterior of the property (on an initial valuation this will involve detailed measurement of floor space etc, but this would need to be reperformed in future full valuations only if there was evidence of a physical change to the buildings);

(b) inspection of the locality;

(c) enquiries of the local planning and similar authorities;

(d) enquiries of the entity or its solicitors; and

(e) research into market transactions in similar properties, identification of market trends, and the application of these to determine the value of the property under consideration.

48 A full valuation of a property is conducted by either:

(a) a qualified external valuer; or

(b) a qualified internal valuer, provided that the valuation has been subject to review by a qualified external valuer. The review involves the valuation of a sample of the entity's properties by the external valuer and comparison with the internal valuer's figures leading to expression of opinion on the overall accuracy of the valuation, based upon analysis of this sample. The external valuer must be satisfied that the sample represents a genuine cross-section of the entity's portfolio.

49 An interim valuation of a property is conducted by a qualified (external or internal) valuer and consists of:

(a) research into market transactions in similar properties, identification of market trends, and the application of these to determine the value of the property under consideration (as in paragraph 47(e));

(b) confirmation that there have been no changes of significance to the physical buildings, the legal rights, or local planning considerations; and

(c) an inspection of the property or the locality by the valuer to the extent that this is regarded as professionally necessary, having regard to all the circumstances of the case, including recent changes to the property or the locality and the date on which the valuer previously inspected the property.

50 For certain tangible fixed assets other than properties, for example company cars, there may be an active second-hand market for the asset, or appropriate indices may exist, such that the entity's directors can establish the asset's value with reasonable reliability. In such cases it may be unnecessary to use the services of a qualified valuer and the valuation should instead be updated annually by the directors. Otherwise, the valuation should be performed by a qualified valuer at

least every five years, with an update in year 3, also performed by a qualified valuer. In addition, the valuation should be updated in the intervening years where it is likely that there has been a material change in value. If a qualified internal valuer is used for the five-yearly valuation, the valuation should be subject to review by a qualified external valuer.

51 For an index to be appropriate for use by the directors in valuing a tangible fixed asset other than property, the index table will:

(a) be appropriate to the class of asset to which it is to be applied, as well as to the asset's location and condition, and take into account technological change; and

(b) have a proven record of regular publication and use and be expected to be available in the foreseeable future.

52 As explained in paragraphs 45, 46 and 50, valuations are to be updated where it is likely that there has been a material change in value. A material change in value is a change in value that would reasonably influence the decisions of a user of the accounts. In assessing whether a material change in value is likely, the combined impact of all relevant factors (eg physical deterioration in the property, general movements in market prices in the area etc) should be considered.

Valuation basis

53 The following valuation bases should be used for revalued properties that are not impaired:

(a) **non-specialised properties should be valued on the basis of existing use value (EUV),* with the addition of notional directly attributable acquisition costs where material. Where the open market value (OMV) is materially different from EUV, the OMV and the reasons for the difference should be disclosed in the notes to the accounts.**

(b) **specialised properties should be valued on the basis of depreciated replacement cost.**

(c) **properties surplus to an entity's requirements should be valued on the basis of OMV, with expected directly attributable selling costs deducted where material.**

54 Where there is an indication of impairment, an impairment review should be performed in accordance with FRS 11. The asset should be recorded at the lower of the revalued amount, determined in accordance with the above paragraph, and recoverable amount (which is the higher of net realisable value† and value in use).

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* *In the case of registered social landlords the valuation of non-specialised properties is based on Existing Use Value for Social Housing as defined in the RICS Appraisal and Valuation Manual.*

† *As the revalued amount of a tangible fixed asset is often close to its net realisable value, any further consideration of impairment is not generally necessary.*

55 Notional directly attributable acquisition costs includes normal dealing costs, such as professional fees, non-recoverable taxes and duties. It does not include expenditure incurred with the objective of enhancing the site value, such as site improvements, costs involved in obtaining planning consent, the cost of site preparation and clearance, or other costs that would already be reflected in EUV. For practical purposes, where notional acquisition costs (or expected selling costs for properties surplus to requirements) are not material they may be ignored.

56 Certain types of non-specialised properties are bought and sold, and therefore valued, as businesses. The EUV of a property valued as an operational entity is determined by having regard to trading potential, but excludes personal goodwill that has been created in the business by the present owner or management and is not expected to remain with the business in the event of the property being sold.

57 Some entities make structural changes to their properties or include special fittings within their properties in order to meet the particular needs of their individual businesses (for example specialised shop fronts on a retail unit). These structural changes and specialised fittings are referred to as 'adaptation works' and have a low or nil market value owing to their specialised nature. In such cases, the adaptation works and shell of the property (ie the property in its state before adaptation) may be treated separately,* with only the shell of the property revalued using EUV. In such a case, the adaptation works are held at depreciated replacement cost or depreciated historical cost.

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* *In accordance with the RICS Appraisal and Valuation Manual, Practice Statement 12.4.*

58 Specialised properties, where a market value is not available, are valued using depreciated replacement cost. The objective of depreciated replacement cost is to make a realistic estimate of the current cost of constructing an asset that has the same service potential as the existing asset.

59 **Tangible fixed assets other than properties should be valued using market value, where possible. Where market value is not obtainable, assets should be valued on the basis of depreciated replacement cost.***

60 For tangible fixed assets other than property that are used in the business, notional directly attributable acquisition costs should be added to market value where material. For other tangible fixed assets that are surplus to requirements, expected selling costs should be deducted if material. Where market value is not obtainable, depreciated replacement cost, which provides a realistic estimate of the value attributable to the remaining service potential of the total useful economic life of the asset, should be used, with the assistance of a qualified valuer.

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* *In accordance with guidance on the 'Value of Plant and Machinery to the Business' set out in Practice Statement 4 in the RICS Appraisal and Valuation Manual. The definition of Value of Plant and Machinery to the Business is reproduced in Appendix I.*

Class of assets

61 **Where a tangible fixed asset is revalued all tangible fixed assets of the same class should be revalued. In those rare cases where it is impossible to obtain a reliable valuation of an asset held outside the UK or the Republic of Ireland the asset may be excluded from the class of assets for the purposes of this paragraph. However, the carrying amount of the tangible fixed asset and the fact that it has not been revalued must be stated.**

62 The separate classes of tangible fixed assets that are shown in the formats in companies legislation are:

(a) land and buildings;

(b) plant and machinery; and

(c) fixtures, fittings, tools and equipment.*

These are broad classes. For the purposes of valuation, entities may, within reason, adopt other, narrower classes that meet the definition of a class of tangible fixed assets and are appropriate to their business. For example, land and buildings may be split into specialised properties, non-specialised properties and short leasehold properties. The disclosures required by paragraphs 74 and 100 should be given for each class of asset adopted by an entity for revaluation purposes.

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* *In Great Britain, the Companies Act 1985, Schedule 4, Part I.*
In Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, Part I.
In the Republic of Ireland, the Companies (Amendment) Act 1986, section 4 and Schedule, Part I.

Reporting gains and losses on revaluation

63 **Revaluation gains should be recognised in the profit and loss account only to the extent (after adjusting for subsequent depreciation) that they reverse revaluation losses on the same asset that were previously recognised in the profit and loss account. All other revaluation gains should be recognised in the statement of total recognised gains and losses.**

64 Where a revaluation gain reverses a revaluation loss that was previously recognised in the profit and loss account, the gain recognised in the profit and loss account is reduced by the amount of depreciation that would have been charged had the loss previously taken to the profit and loss account not been recognised in the first place. This is to achieve the same overall effect that would have been reached had the original downward revaluation reflected in the profit and loss account not occurred.

65 **All revaluation losses that are caused by a clear consumption of economic benefits should be recognised in the profit and loss account. Other revaluation losses should be recognised:**

(a) in the statement of total recognised gains and losses until the carrying amount reaches its depreciated historical cost; and

(b) thereafter, in the profit and loss account unless it can be demonstrated that the recoverable amount of the asset is greater than its revalued amount, in which case the loss should be recognised in the statement of total recognised gains and losses to the extent that the recoverable amount of the asset is greater than its revalued amount.

66 **For the purposes of paragraph 65(b), the recoverable amount of an asset should be calculated in accordance with the requirements of FRS 11.**

67 **In determining in which performance statement gains and losses on revaluation should be recognised, material gains and losses on individual assets in a class of asset should not be aggregated.**

68 A downward revaluation may comprise, at least in part, an impairment loss. When it is obvious that there has been a consumption of economic benefits (eg physical damage or a deterioration in the quality of the service provided by the asset), the asset is clearly impaired and the loss recognised in the profit and loss account, as an operating cost similar to depreciation.

69 Other revaluation losses may be due in part to a general fall in prices (eg a general slump in the property market) and in part to a consumption of economic benefits. Unless there is evidence to the contrary, it is assumed that the fall in value from the asset's previous carrying amount to depreciated historical cost is due to a general fall in prices (which is recognised in the statement of total recognised gains and losses, as a valuation adjustment) and the fall in value from depreciated historical cost to the revalued amount is due to a consumption of economic benefits (and therefore recognised in the profit and loss account).

70 However, where it can be demonstrated that recoverable amount is greater than the revalued amount, the difference between recoverable amount and the revalued amount is clearly not an impairment and should therefore be recognised in the statement of total recognised gains and losses as a valuation adjustment, rather than the profit and loss account.

71 Paragraphs 63-70 do not apply to assets held by insurance companies and insurance groups (including assets of the long-term business), as part of their insurance operations, where revaluation changes are included in the profit and loss account.

Example—Reporting revaluation gains and losses

Assumptions

A non-specialised property costs £1 million and has a useful life of 10 years and no residual value. It is depreciated on a straight-line basis and revalued annually. The entity has a policy of calculating depreciation based on the opening book amount. At the end of years 1 and 2 the asset has an EUV of £1,080,000 and £700,000 respectively. At the end of year 2, the recoverable amount of the asset is £760,000 and its depreciated historical cost is £800,000. There is no obvious consumption of economic benefits in year 2, other than that accounted for through the depreciation charge.

Accounting treatment under modified historical cost

	Year 1	Year 2
	£000	£000
Opening book amount	1,000	1,080
Depreciation	(100)	(120)*
Adjusted book amount	900	960
Revaluation gain (loss)		
• recognised in the STRGL	180	(220)
• recognised in the profit and loss account	—	(40)
Closing book amount	1,080	700

continued

* *As the remaining useful economic life of the asset is nine years, the depreciation charge in year 2 is 1/9th of the opening book amount (£1,080,000/9 = £120,000).*

Example - continued

In year 1, after depreciation of £100,000, a revaluation gain of £180,000 is recognised in the statement of total recognised gains and losses, in accordance with paragraph 63.

In year 2, after a depreciation charge of £120,000, the revaluation loss on the property is £260,000. According to paragraph 65, where there is not a clear consumption of economic benefits, revaluation losses should be recognised in the statement of total recognised gains and losses until the carrying amount reaches its depreciated historical cost. Therefore, the fall in value from the adjusted book amount (£960,000) to depreciated historical cost (£800,000) of £160,000 is recognised in the statement of total recognised gains and losses.

The rest of the revaluation loss, £100,000 (ie the fall in value from depreciated historical cost (£800,000) to the revalued amount (£700,000)), should be recognised in the profit and loss account, unless it can be demonstrated that recoverable amount is greater than the revalued amount. In this case, recoverable amount of £760,000 is greater than the revalued amount of £700,000 by £60,000. Therefore £60,000 of the revaluation loss is recognised in the statement of total recognised gains and losses, rather than the profit and loss account—giving rise to a total revaluation loss of £220,000 (£60,000+£160,000) that is recognised in the statement of total recognised gains and losses. The remaining loss (representing the fall in value from depreciated historical cost of £800,000 to recoverable amount of £760,000) of £40,000 is recognised in the profit and loss account.

Reporting gains and losses on disposal

72 **The profit or loss on the disposal of a tangible fixed asset should be accounted for in the profit and loss account of the period in which the disposal occurs as the difference between the net sale proceeds and the carrying amount, whether carried at historical cost (less any provisions made) or at a valuation. Profits or losses on the disposal of fixed assets should be shown in accordance with FRS 3 'Reporting Financial Performance'.**

73 Where an asset (or a component of an asset) is replaced, its carrying amount is removed from the balance sheet (by eliminating its cost (or revalued amount) and related accumulated depreciation) and the resulting gain or loss on disposal is recorded in accordance with paragraph 72. For example, a new tangible fixed asset may be acquired from insurance proceeds when a previously held tangible fixed asset has been lost or destroyed. In such cases the lost or destroyed asset is removed from the balance sheet and the resulting gain or loss on disposal (being the difference between the carrying amount and the insurance proceeds) is recognised. The replacement asset is recorded at its cost.

Disclosures

74 **In addition to the disclosures required by paragraphs 53(a), 61 and 72, where any class of tangible fixed assets of an entity has been revalued the following information should be disclosed in each reporting period:**

(a) for each class of revalued assets:

(i) the name and qualifications of the valuer(s) or the valuer's organisation and a description of its nature;

(ii) the basis or bases of valuation (including whether notional directly attributable acquisition costs have been included or expected selling costs deducted);

(iii) the date and amounts of the valuations;

(iv) where historical cost records are available, the carrying amount that would have been included in the financial statements had the tangible fixed assets been carried at historical cost less depreciation;

(v) whether the person(s) carrying out the valuation is (are) internal or external to the entity;

(vi) where the directors are not aware of any material change in value and therefore the valuation(s) have not been updated, as described in paragraphs 45, 46 and 50, a statement to that effect; and

(vii) where the valuation has not been updated, or is not a full valuation, the date of the last full valuation.

(b) in addition, for revalued properties:

(i) where properties have been valued as fully-equipped operational entities having regard to their trading potential, a statement to that effect and the carrying amount of those properties; and

(ii) the total amount of notional directly attributable acquisition costs (or the total amount of expected selling costs deducted), included in the carrying amount, where material.

75 Other professional bodies may require disclosures in the financial statements in addition to the above disclosures. For example, the RICS requires confirmation in a published document containing a reference to a valuation report that the valuation has been made in accordance with the RICS *Appraisal and Valuation Manual* or a (named) alternative pursuant to Practice Statement 1.2.2, or the extent of and reason(s) for departure therefrom.

76 In addition, companies legislation* requires disclosure, in the directors' report, of the difference, with such precision as is practicable, between the carrying

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* *In Great Britain, the Companies Act 1985, Schedule 7, paragraph 1(2).*
In Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 7, paragraph 1(2).
In the Republic of Ireland, the Companies Act 1963, section 158. (Note: this section includes a general requirement for the directors' report to deal with the state of affairs of the company; there is no specific requirement as in the UK references.)

amount and market value of interests in land,* where, in the opinion of the directors, it is of such significance that it needs to be drawn to the attention of the members of the entity.

Depreciation

Depreciable amount

77 **The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful economic life. The depreciation method used should reflect as fairly as possible the pattern in which the asset's economic benefits are consumed by the entity. The depreciation charge for each period should be recognised as an expense in the profit and loss account unless it is permitted to be included in the carrying amount of another asset.**

78 The fundamental objective of depreciation is to reflect in operating profit the cost of use of the tangible fixed assets (ie amount of economic benefits consumed) in the period. This requires a charge to operating profit even if the asset has risen in value or been revalued.

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* *In Great Britain, Schedule 1 to the Interpretation Act 1987 states that '"Land" includes buildings and other structures, land covered with water, and any estate, interest, easement, servitude or right in or over land'.*

In Northern Ireland, section 45 (i)(a) of the Interpretation Act (Northern Ireland) 1954 states that '(a) "Land" shall include- (i) messuages, tenements and hereditaments of any tenure; (ii) land covered by water; (iii) any estate in land or water; and (iv) houses or other buildings or structures whatsoever;'.

79 Where an asset has been revalued the current period's depreciation charge is based on the revalued amount and the remaining useful economic life. Ideally, the average value of the asset for the period should be used to calculate the depreciation charge. In practice, however, either the opening or closing balance may be used instead, provided that it is used consistently each period.

80 The economic benefits embodied in a tangible fixed asset are consumed by the entity principally through the use of the asset. However, other factors often also result in the diminution of the economic benefits that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful economic life, residual value and depreciation method of an asset:

- the expected usage of the asset by the entity, assessed by reference to the asset's expected capacity or physical output
- the expected physical deterioration of the asset through use or effluxion of time; this will depend upon the repair and maintenance programme of the entity both when the asset is in use and when it is idle
- economic or technological obsolescence, for example arising from changes or improvements in production, or a change in the market demand for the product or service output of that asset
- legal or similar limits on the use of the asset, such as the expiry dates of related leases.

81 A variety of methods can be used to allocate the depreciable amount of a tangible fixed asset on a systematic basis over its useful economic life. The method chosen should result in a depreciation charge throughout the asset's useful economic life and not just towards the end of its useful economic life or when the asset is falling in value. Two of the more common methods are:

(a) Straight-line—Here it is assumed that equal amounts of the asset's economic benefits are consumed in each year of the asset's estimated useful economic life. Therefore the asset is written off in equal instalments over its estimated useful economic life.

(b) Reducing balance—This method more closely reflects the pattern of consumption of the economic benefits of assets that clearly provide greater benefits when new than as they become older—perhaps as a result of general wear causing them to become more prone to breakdown, or less capable of producing a high-quality product, or because they will necessarily be less technologically advanced than the latest model.

Where the pattern of consumption of an asset's economic benefits is uncertain, a straight-line method of depreciation is usually adopted.

82 **A change from one method of providing depreciation to another is permissible only on the grounds that the new method will give a fairer presentation of the results and of the financial position. Such a change does not, however, constitute a change of accounting policy; the carrying amount of the tangible fixed asset is depreciated using the revised method over the remaining useful economic life, beginning in the period in which the change is made.**

83 **Where the tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life.**

84 Land and buildings are separable components and are dealt with separately for accounting purposes, even when they are acquired together. With certain exceptions, such as sites used for extractive purposes or landfill, land has an unlimited life and therefore is not depreciated. Buildings have a limited life and therefore are depreciated. An increase in the existing use value of the land on which a building stands does not affect the determination of the useful economic life or residual value of the building. Another example of separable components that may have substantially different useful economic lives is the structure of a building and items within the structure such as general fittings.

85 It would not be appropriate, however, to treat the trading potential associated with a property that is valued as an operational entity, such as a public house or hotel, as a separate component, where the value and life of any such trading potential is inherently inseparable from that of the property.

86 **Subsequent expenditure on a tangible fixed asset that maintains or enhances the previously assessed standard of performance of the asset does not negate the need to charge depreciation.**

87 In calculating the useful economic life of an asset it is assumed that subsequent expenditure will be undertaken to maintain the previously assessed standard of performance of the asset (for example the cost of servicing or routine overhauling of plant and equipment). Without such expenditure the depreciation expense would be increased because the useful economic life or residual value of the asset would be reduced. This type of expenditure is recognised as an expense when incurred in accordance with paragraph 34.

88 In addition, subsequent expenditure may be undertaken that results in an enhancement of the economic benefits of the asset in excess of the previously assessed standard of performance, or the restoration or replacement of a component of the asset that has been separately depreciated, or the restoration of the economic benefits of a tangible fixed asset where the cost of an overhaul or inspection of the tangible fixed asset has been reflected in previous depreciation. This type of expenditure may result in an extension of the useful economic life of the asset, but cannot extend the useful economic life of the asset indefinitely and does not negate the need to charge depreciation. In accordance with paragraph 36 the subsequent expenditure is capitalised as it is incurred and depreciated over the asset's or the component's useful economic life, or the period to the next major overhaul or inspection, as appropriate.

89 Tangible fixed assets, other than non-depreciable land, should be reviewed for impairment, in accordance with FRS 11, at the end of each reporting period when either:

(a) no depreciation charge is made on the grounds that it would be immaterial (either because of the length of the estimated remaining useful economic life or because the estimated residual value of the tangible fixed asset is not materially different from the carrying amount of the asset); or

(b) the estimated remaining useful economic life of the tangible fixed asset exceeds 50 years.

90 For tangible fixed assets other than non-depreciable land, the only grounds for not charging depreciation are that the depreciation charge and accumulated depreciation are immaterial. The depreciation charge and accumulated depreciation are immaterial if they would not reasonably influence the decisions of a user of the accounts.

91 An entity must be able to justify that the uncharged depreciation is not material in aggregate as well as for each tangible fixed asset. Depreciation may be immaterial because of very long useful economic lives or high residual values (or both). A high residual value will reflect the remaining economic value of the asset at the end of its useful economic life to the entity. These conditions may occur when:

(a) the entity has a policy and practice of regular maintenance and repair (charges for which are recognised in the profit and loss account) such that the asset is kept to its previously assessed standard of performance; and

(b) the asset is unlikely to suffer from economic or technological obsolescence (eg due to potential changes in demand in the market following changes in fashion); and

(c) where estimated residual values are material:

(i) the entity has a policy and practice of disposing of similar assets well before the end of their economic lives; and

(ii) the disposal proceeds of similar assets (after excluding the effect of price changes since the date of acquisition or last revaluation) have not been materially less than their carrying amounts.

92 Where it is not reasonably practicable to perform impairment reviews on an individual asset basis, they should be performed for groups of assets, as part of income-generating units, in accordance with FRS 11. After the first period the reviews need only be updated. If expectations of future cash flows and discount rates have not changed significantly, the updating procedure will be relatively quick to perform. If there have been no adverse changes in the key assumptions and variables, or if the estimated recoverable amount was previously substantially in excess of the carrying amount, it may even be possible to ascertain immediately that the asset or income-generating unit is not impaired.

Review of useful economic life and residual value

93 **The useful economic life of a tangible fixed asset should be reviewed at the end of each reporting period and revised if expectations are significantly different from previous estimates. If a useful economic life is revised, the carrying amount of the tangible fixed asset at the date of revision should be depreciated over the revised remaining useful economic life.**

94 If a tangible fixed asset is carried in the balance sheet at a revaluation (particularly if valued using depreciated replacement cost), a reassessment of useful economic life may necessitate a revaluation of the asset, in accordance with paragraphs 43, 45, 46 and 50. The revalued amount should be depreciated over the revised useful economic life.

95 Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes based on prices prevailing at the date of acquisition (or revaluation). A change in its estimated residual value should be accounted for prospectively over the asset's remaining useful economic life, except to the extent that the asset has been impaired at the balance sheet date.

96 The reassessed residual value is, where practicable, restated in terms of the price level that existed when the asset was purchased (or revalued). Where such a restatement is not practicable, the residual value is restated in terms of current values only where the residual value at current prices is below the original estimate of residual value. Events or changes in circumstances that cause the residual value to fall may also be indicative of an impairment of the asset (ie when the asset's recoverable amount falls below its carrying amount), in which case an impairment review should be performed in accordance with FRS 11.

Renewals accounting

97 **Definable major assets or components within an infrastructure system or network with determinable finite lives should be treated separately and depreciated over their useful economic lives. For the remaining tangible fixed assets within the system or network ('the infrastructure asset'), renewals accounting (as outlined in paragraph 98) may be used as a method of estimating depreciation in the following circumstances:**

(a) the infrastructure asset is a system or network that as a whole is intended to be maintained at a specified level of service potential by the continuing replacement and refurbishment of its components; and

(b) the level of annual expenditure required to maintain the operating capacity (or service capability) of the infrastructure asset is calculated from an asset management plan that is certified by a person who is appropriately qualified and independent; and

(c) the system or network is in a mature or steady state.

98 **Where renewals accounting is adopted, the level of annual expenditure required to maintain the operating capacity of the infrastructure asset is treated as the depreciation charged for the period and is deducted from the carrying amount of the asset (as part of accumulated depreciation). Actual expenditure is capitalised (as part of the cost of the asset) as incurred.**

99 In the above circumstances, it is appropriate to treat the infrastructure asset as a single network of systems (ie one asset, except for definable major components with determinable finite lives), rather than as a number of individual assets. Evidence that a system or network is in a mature and steady state is provided when the annual cost of maintaining that system is relatively constant. In addition, attention should be given to removing the carrying amount of that part of the infrastructure asset that is replaced or restored by the subsequent expenditure. If the above treatment of accounting for infrastructure assets is not adopted, then expenditure to maintain the operating capacity of the infrastructure assets would be recognised in accordance with paragraphs 34 and 36, and depreciation calculated in the conventional manner, in accordance with paragraphs 77–96.

Disclosures

100 **The following information should be disclosed separately in the financial statements for each class of tangible fixed assets:**

(a) the depreciation methods used;

(b) the useful economic lives or the depreciation rates used;

(c) total depreciation charged for the period;

(d) where material, the financial effect of a change during the period in either the estimate of useful economic lives (made in accordance with paragraph 93) or the estimate of residual values (made in accordance with paragraph 95);

(e) the cost or revalued amount at the beginning of the financial period and at the balance sheet date;

(f) the cumulative amount of provisions for depreciation or impairment at the beginning of the financial period and at the balance sheet date;

(g) a reconciliation of the movements, separately disclosing additions, disposals, revaluations, transfers, depreciation, impairment losses, and reversals of past impairment losses written back in the financial period; and

(h) the net carrying amount at the beginning of the financial period and at the balance sheet date.

101 When a tangible fixed asset is revalued, the carrying amount of the asset is restated at its revalued amount. Usually any accumulated depreciation at the date of revaluation is eliminated and the cost or revalued amount of the asset is restated at its revalued amount. Alternatively, where the valuation is calculated on a depreciated replacement cost basis, both the cost or revalued amount and the accumulated depreciation at the date of revaluation may be restated, so that the carrying amount of the asset after revaluation equals its revalued amount.

102 Where there has been a change in the depreciation method used, the effect, if material, should be disclosed in the period of change. The reason for the change should also be disclosed.

Date from which effective and transitional arrangements

103 **The accounting practices set out in the FRS should be regarded as standard in respect of financial statements relating to accounting periods ending on or after 23 March 2000. Earlier adoption is encouraged.**

104 **Where, on implementation of the FRS for the first time, an entity does not adopt a policy of revaluation, but the carrying amount of its tangible fixed assets reflects previous revaluations, it may:**

(a) retain the book amounts (subject to the requirement to test the assets for impairment in accordance with FRS 11 where there is an indication that an impairment may have occurred). In these circumstances the entity should disclose the fact that the transitional provisions of the FRS are being followed and that the valuation has not been updated and give the date of the last revaluation; or

(b) restate the carrying amount of the tangible fixed assets to historical cost (less restated accumulated depreciation), as a change in accounting policy.

105 The transitional arrangement set out in paragraph 104(a) is available only on the first application of the FRS.

106 **Except as provided for in paragraph 108, revisions to the useful economic lives and residual values of tangible fixed assets recognised on adoption of the FRS are not the result of a change in accounting policy and should be treated in accordance with paragraphs 93-96 and not as prior period adjustments.**

107 Revisions to the useful economic lives or residual values of tangible fixed assets may result in the depreciation of tangible fixed assets that were previously not depreciated by the entity on the grounds of immateriality. In such cases, the carrying amounts of the tangible fixed assets should be depreciated prospectively over the remaining useful economic lives of the assets.

108 **Where, on adoption of the FRS, entities separate tangible fixed assets into different components with significantly different useful economic lives for depreciation purposes, in accordance with paragraphs 36-41 and 83-85, the changes should be dealt with as prior period adjustments, as a change in accounting policy.***

Amendment to SSAP 19 and withdrawal of SSAP 12

109 **Paragraph 9 of SSAP 19 'Accounting for investment properties' is deleted.**

110 **The FRS supersedes SSAP 12 'Accounting for depreciation'.**

* *In accordance with FRS 3 and UITF Abstract 14 'Disclosure of changes in accounting policy'.*

ADOPTION OF FRS 15 BY THE BOARD

Financial Reporting Standard 15 – 'Tangible Fixed Assets' was approved for issue by the ten members of the Accounting Standards Board.

Sir David Tweedie	(Chairman)
Allan Cook	(Technical Director)
David Allvey	
Ian Brindle	
Dr John Buchanan	
John Coombe	
Raymond Hinton	
Huw Jones	
Professor Geoffrey Whittington	
Ken Wild	

APPENDIX I

RICS DEFINITIONS

The following definitions have been extracted from the *Appraisal and Valuation Manual* published by RICS Books and are reproduced with the permission of the Royal Institution of Chartered Surveyors, which owns the copyright.

Specialised properties:-

"those which, due to their specialised nature, are rarely, if ever, sold on the open market for single occupation for a continuation of their existing use, except as part of a sale of the business in occupation. Their specialised nature may arise from the construction, arrangement, size or location of the property, or a combination of these factors, or may be due to the nature of the plant and machinery and items of equipment which the buildings are designed to house, or the function, or the purpose for which the buildings are provided. Examples of specialised properties, which are usually valued on the Depreciated Replacement Cost (DRC) basis, are:

(a) oil refineries and chemical works where, usually, the buildings are no more than housings or cladding for highly specialised plant;

(b) power stations and dock installations where the buildings and site engineering works are related directly to the business of the owner, it being highly unlikely that they would have a value to anyone other than a company acquiring the undertaking;

(c) properties of such construction, arrangement, size or specification that there would be no market (for a sale to a single owner occupier for the continuation of existing use) for those buildings;

(d) standard properties in particular geographical areas and remote from main business centres, located there for operational or business reasons, which are of such an abnormal size for that district, that there would be no market for such buildings there;

(e) schools, colleges, universities and research establishments where there is no competing market demand from other organisations using these types of property in the locality;

(f) hospitals, other specialised health care premises and leisure centres where there is no competing market demand from other organisations wishing to use these types of property in the locality; and

(g) museums, libraries, and other similar premises provided by the public sector."

Non-specialised properties:-

"all properties except those coming within the definition of specialised properties. Hence they are those for which there is a general demand, with or without adaptation, and which are commonly bought, sold or leased on the open market for their existing or similar uses, either with vacant possession for single occupation, or (whether tenanted or vacant) as investments or for development. Residential properties, shops, offices, standard industrial and warehouse buildings, public houses, petrol filling stations, and many others, are usually *non-specialised properties*."

Open market value:-

"An opinion of the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

(a) a willing seller;

(b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;

(c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;

(d) that no account is taken of any additional bid by a prospective purchaser with a special interest; and

(e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion."

Existing use value:-

"An opinion of the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

(a) a willing seller;

(b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;

(c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;

(d) that no account is taken of any additional bid by a prospective purchaser with a special interest;

(e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion;

(f) that the property can be used for the foreseeable future only for the existing use; and

(g) that vacant possession is provided on completion of the sale of all parts of the property occupied by the business."

Depreciated replacement cost (of property):-

"The aggregate amount of the value of the land for the existing use or a notional replacement site in the same locality, and the gross replacement cost of the buildings and other site works, from which appropriate deductions may then be made to allow for the age, condition, economic or functional obsolescence, environmental and other relevant factors; all of these might result in the existing property being worth less to the undertaking in occupation than would a new replacement."

Value of plant and machinery to the business:-

"An opinion of the price at which an interest in the plant and machinery utilised in a business would have been transferred at the date of valuation assuming:

(a) that the plant and machinery will continue in its present uses in the business;

(b) adequate potential profitability of the business, or continuing viability of the undertaking, both having due regard to the value of the total assets employed and the nature of the operation; and

(c) that the transfer is part of an arm's length sale of the business wherein both parties acted knowledgeably, prudently and without compulsion."

APPENDIX II

NOTE ON LEGAL REQUIREMENTS

Great Britain

1 In Great Britain, the statutory requirements relating to accounting for tangible fixed assets are set out in the Companies Act 1985. The main requirements that are directly relevant to tangible fixed assets and the requirements of FRS 15 are set out in Schedules 4 and 4A and are summarised below.

2 Schedule 4 does not apply to banking and insurance companies or groups. Requirements equivalent to those of Schedule 4 are contained in Schedule 9 (for banking companies and groups) and in Schedule 9A (for insurance companies and groups).

Initial cost

3 Paragraph 17 of Schedule 4 requires the amount to be included in respect of any fixed asset to be its purchase price or production cost. The purchase price is to be determined by adding to the actual price any expenses incidental to its acquisition (paragraph 26(1) of Schedule 4). Paragraph 26(2) requires the cost of production of an asset to comprise the purchase price of raw materials and consumables used and the amount of costs incurred by the company that are directly attributable to the production of that asset. In addition, paragraph 26(3) allows the inclusion of:

(a) indirectly attributable costs incurred by the company relating to the period of production; and

(b) interest on capital borrowed to finance the production of the asset. (However, the amount of the interest capitalised is required to be disclosed in the notes to the accounts.)

4 Where there is no record of the purchase price or production cost of any asset of a company, paragraph 28 of Schedule 4 requires the asset value to be determined using the earliest available record of the value of the asset on or after its acquisition or production by the company. Such earliest available records may also be used where there are no relevant prices, expenses or costs against which the purchase price may be determined or where the record of such purchase price cannot be obtained without unreasonable expense or delay.

Valuation

5 The alternative accounting rules set out in paragraph 31(2) of Schedule 4 permit tangible fixed assets to be included at a market value determined as at the date of their last valuation or at their current cost.

6 Where the alternative accounting rules set out in paragraph 31(2) of Schedule 4 are adopted by a company the following additional information is required to be included in the company's accounts:

(a) the assets revalued and the basis of valuation (paragraph 33(2) of Schedule 4).

(b) either the comparable amounts determined according to the historical cost accounting rules or the differences between those amounts and the revalued amounts (paragraph 33(3) of Schedule 4).

(c) the year and amount of the valuation (paragraph 43(a) of Schedule 4).

(d) in the case of assets that have been valued during the financial year, the names of the persons who valued them or particulars of their qualifications for doing so and the bases of valuation used by them (paragraph 43(b) of Schedule 4).

Reporting revaluation gains and losses

7 A revaluation gain is required by the FRS to be recognised in the statement of total recognised gains and losses, unless it reverses a previous revaluation loss that has been recognised in the profit and loss account. This requirement is consistent with paragraph 34(1) of Schedule 4, which requires the "amount of any profit" (ie gain) "or loss" calculated under the alternative accounting rules to be "credited to a separate reserve (the revaluation reserve)". The requirement for a revaluation gain to be recognised in the profit and loss account to the extent that it reverses a revaluation loss previously recognised in the profit and loss account is consistent with paragraph 34(3) of Schedule 4, which explicitly authorises transfers to take place between the revaluation reserve and the profit and loss account provided that the relevant amount was previously charged to that account.

8 The FRS requires all revaluation losses that are clearly due to the consumption of economic benefits to be recognised in the profit and loss account. This requirement is consistent with paragraph 19(2) of Schedule 4, which requires provisions for depreciation or permanent diminution in value to be recognised in the profit and loss account.

9 For other revaluation losses where it *can* be demonstrated that the recoverable amount of the asset is greater than its revalued amount, the FRS requires the difference between recoverable amount and revalued amount to be recognised in the statement of total recognised gains and losses. In this situation there has been no diminution in value under paragraph 19(2) of Schedule 4 and therefore the loss can remain in the revaluation reserve in accordance with paragraph 34(1) of Schedule 4.

10 For other revaluation losses where it *cannot* be demonstrated that the recoverable amount of the asset is greater than its revalued amount, an impairment loss arises. Where a fixed asset is impaired, it will always be the case that both the value in use and the net realisable value will be below the carrying amount. In the case of a revalued fixed asset, it would be reasonable to reflect the uncertainty as to the permanence of any impairment by treating it as a reversal of any revaluation previously recognised. Such an impairment would be dealt with through the statement of total recognised gains and losses (ie as a revaluation reserve movement). However, if the impairment results in a carrying amount below depreciated historical cost, then, as in a pure historical cost context, it would be reasonable to treat that part of the impairment as being of a permanent nature and charge it to the profit and loss account.

Depreciation

11 Where a fixed asset has a limited useful economic life, paragraph 18 of Schedule 4 requires its purchase price or production cost less its estimated residual value to be written off systematically over the period of the asset's useful economic life.

12 Paragraph 32(1) of Schedule 4 requires the depreciation of revalued assets to be calculated on the basis of their latest valuations. Paragraph 32(3) allows a company to include under the relevant profit and loss account heading provisions for depreciation for the revalued assets based only on their historical cost, provided that the difference between that and the provision for depreciation calculated on the revalued amount is shown separately either in the profit and loss account or in the notes. It is unclear, however, whether the whole depreciation charge is required to be recognised in the profit and loss account (see discussion in Appendix IV 'The development of the FRS').

Disclosure requirements

13 In addition to the disclosures mentioned in paragraph 6 above in connection with the revaluation of tangible fixed assets, the following disclosures are required:

(a) Paragraph 36 of Schedule 4 requires the disclosure of the accounting policies adopted by a company (including the policies regarding the depreciation and diminution in value of assets).

(b) Paragraph 26(3) requires the disclosure of the amount of interest capitalised, where such a policy is adopted.

(c) Paragraph 42 details the disclosures required of the movement on tangible fixed asset balances for the items under each of the headings for tangible fixed assets set out in the balance sheet formats in Schedule 4, as follows:

1. Land and buildings

2. Plant and machinery

3. Fixtures, fittings, tools and equipment

4. Payments on account and assets in the course of construction.

(d) Paragraph 1(2) of Schedule 7 requires disclosure, in the directors' report, of the difference, with such precision as is practicable, between the carrying amount and market value of interests in land, where, in the opinion of the directors, it is of such significance that it needs to be drawn to the attention of the members of the entity.

Northern Ireland

14 The statutory requirements in Northern Ireland are set out in the Companies (Northern Ireland) Order 1986. They are identical to and parallel the references in the legislation for Great Britain cited above.

Republic of Ireland

15 The statutory requirements in the Republic of Ireland that correspond to those cited above for Great Britain are shown in the following table.

Great Britain	*Republic of Ireland*
Schedule 4 to the Companies Act 1985:	The Schedule to the Companies (Amendment) Act 1986:
paragraph 17	paragraph 5
paragraph 18	paragraph 6
paragraph 19(2)	paragraph 7(2)
paragraph 26(1), (2) and (3)	paragraph 14(1), (2) and (3)
paragraph 28	paragraph 16
paragraph 31(2)	paragraph 19(2)
paragraph 32(1) and (3)	paragraph 20(1) and (3)
paragraph 33(2) and (3)	paragraph 21(2) and (3)
paragraph 34(1) and (3)	paragraph 22(1) and (4)
paragraph 36	paragraph 24
paragraph 42	paragraph 29
paragraph 43(a) and (b)	paragraph 30(a) and (b)
Schedule 4A to the Companies Act 1985	European Communities (Companies: Group Accounts) Regulations 1992
Schedule 7 to the Companies Act 1985, paragraph 1(2)	The Companies Act 1963, section 158*
Schedule 9 to the Companies Act 1985	European Communities (Credit Institutions: Accounts) Regulations 1992
Schedule 9A to the Companies Act 1985	European Communities (Insurance Undertakings: Accounts) Regulations 1996

* *Note: this section includes a general requirement for the directors' report to deal with the state of affairs of the company; there is no specific requirement as in the UK references.*

APPENDIX III

COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

1 The main requirements for the recognition, measurement and depreciation of tangible fixed assets are included in International Accounting Standard (IAS) 16 (revised 1998) 'Property, Plant and Equipment'. In addition, some other relevant requirements are included in IAS 23 (revised 1993) 'Borrowing Costs'.

2 The requirements in the FRS lead to compliance with IAS 16 and the relevant requirements of IAS 23 in all main respects, except as discussed below.

Fair/current value

3 Both the FRS and IAS 16 require that, where a policy of revaluation is adopted, the revalued tangible fixed assets should be carried at current values. IAS 16 uses the term 'fair value' and states that the fair value of land and buildings, plant and equipment is usually their market value, but where there is no evidence of market value depreciated replacement cost should be used instead.

4 As explained in Appendix IV 'The development of the FRS', the valuation requirements in the FRS are based on the value to the business model and therefore define current value as the lower of replacement cost and recoverable amount. The Board believes that this gives a more precise and clearer indication of the amount at which the asset should be revalued and therefore prefers this terminology to the use of the term 'fair value'.

5 Accordingly, the FRS requires non-specialised properties to be valued at existing use value, with the addition of notional directly attributable acquisition costs, if material, to reflect replacement cost. Similarly, specialised properties should be valued using depreciated replacement cost. However, properties surplus to requirements should be valued at net realisable value—ie open market value less expected selling costs, if material. Similar valuation bases are required for tangible fixed assets other than property. IAS 16 is silent in respect of whether valuations should be on an existing use basis and whether material direct acquisition or selling costs should be added/deducted.

Revaluation gains and losses

6 The requirements of IAS 16 differ from those in the FRS in two main respects:

- To be consistent with FRS 11 'Impairment of Fixed Assets and Goodwill', the FRS requires revaluation losses that are clearly caused by the consumption of economic benefits to be recognised in the profit and loss account (paragraph 65). The Board believes that such losses are operating costs similar to depreciation and should be treated as such by recognition in the profit and loss account. IAS 16 does not have a similar requirement.

- IAS 16 permits only those losses that reverse revaluation gains that were previously recognised in the statement of total recognised gains and losses to be recognised in that statement. The FRS requires other losses to be recognised in the statement of total recognised gains and losses to the extent that the asset's recoverable amount is greater than its revalued amount. The Board believes that such losses, which have been demonstrated not to be impairments, are in the nature of losses caused by a general fall in prices.

Depreciation

7 Both the FRS and IAS 16 state that subsequent expenditure does not negate the need for depreciation. However, the FRS takes this one step further by also requiring impairment reviews at the end of each reporting period where depreciation is not charged on the basis of immateriality or where the remaining useful economic life is estimated to be greater than 50 years.

Disclosures

8 IAS 16 requires the following additional disclosures:

(a) in general:

- property, plant and equipment pledged as security for liabilities,* and the existence and amounts of restrictions on title
- the amount of expenditures on account of property, plant and equipment in the course of construction
- the amount of commitments for the acquisition of property, plant and equipment.*

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* *These disclosures are required by companies legislation, as follows:*
in Great Britain, the Companies Act 1985, Schedule 4, paragraphs 48(4), 50(1), 50(3) and 50(5).
in Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, paragraphs 48(4), 50(1), 50(3) and 50(5).
in the Republic of Ireland, the Companies (Amendment) Act 1986, Schedule, paragraphs 34(1), 36(1), 36(3) and 36(6).

(b) in respect of each class of property, plant and equipment:

- the measurement bases used for determining the gross carrying amount

(c) in respect of each revalued class of property, plant and equipment:

- the nature of any indices used to determine replacement cost

- the revaluation surplus,* indicating the movement for the period and any restrictions on the distribution of the balance to shareholders.

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* *These disclosures are required by companies legislation, as follows:*
in Great Britain, the Companies Act 1985, Schedule 4, paragraphs 34(2), 42(1) and 46(1).
in Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, paragraphs 34(2), 42(1) and 46(1).
in the Republic of Ireland, the Companies (Amendment) Act 1986, Schedule, paragraphs 22(3), 29(1) and 32(1).

APPENDIX IV

THE DEVELOPMENT OF THE FRS

The need for a standard

1 Many of the principles for determining the cost of tangible fixed assets when they are initially recognised and measured are well known and accepted. However, as no previous accounting standard dealt with these issues, differences in practice have arisen.

2 Many entities adopted a policy of valuing specific tangible fixed assets as permitted by the alternative accounting rules in companies legislation.* Previous practices allowed valuations of assets to be made at an entity's discretion and there was no requirement for valuations to be updated in subsequent accounting periods. Replacing the historical cost of an asset with a valuation provides more relevant information to the user of the accounts. Nevertheless, the relevance of this information diminishes over time as it no longer reflects the current value of the tangible fixed asset. Finally, an entity could revalue some but not all of its tangible fixed assets, with little constraint imposed by the need to treat similar assets consistently. As a result, it was often difficult to understand the amounts attributable to the entity's assets and accordingly to make comparisons from year to year and between similar entities.

* *For example 65 per cent of companies included in the Company Reporting database carried revalued tangible fixed assets in their accounts. However, Company Reporting noted that half of these companies did not have any valuations that were more recent than five years old. (Company Reporting No 80 February 1997)*

3 In respect of depreciation, SSAP 12 'Accounting for depreciation', which this FRS supersedes, was generally regarded as broadly satisfactory. However, it became apparent that some of the requirements of SSAP 12 required clarification. In particular, clarification was sought on the accounting treatment adopted by a number of entities that did not depreciate certain assets, most commonly properties, on the grounds that they were either increasing in value or being maintained or refurbished regularly.

4 The FRS addresses these concerns by specifying accounting rules for the initial recognition, valuation and depreciation of tangible fixed assets, other than investment properties. In developing the FRS, the Board has considered the comments on its initial proposals which were set out in the Discussion Paper 'Measurement of Tangible Fixed Assets' and on its subsequent proposals in FRED 17 'Measurement of Tangible Fixed Assets'.

Initial cost

Decommissioning costs

5 In accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' a provision may be recognised for a present obligation in respect of decommissioning costs: such costs may include those relating to the dismantling and removal of a facility and the restoration of a site. Providing for these costs reflects the obligation of the entity that arises as a consequence of the construction or acquisition of the asset, and which cannot be avoided by the entity's future actions.

6 This FRS states that these costs, to the extent that they qualify for recognition as a provision under FRS 12, should be capitalised as a directly attributable cost of the relevant asset (even though they may not be paid until the end of the asset's life). Treating these costs as part of the cost of the relevant asset acknowledges that the entity has undertaken the obligation to meet these costs in order to derive the benefits of the service potential provided by the asset. This has the consequence that these costs are charged to the profit and loss account as depreciation over the asset's life.

Donated tangible fixed assets

7 Charities often receive gifts and donations of assets. Donated tangible fixed assets do not have a cost to the charity, and therefore their initial measurement should be their current value at the date of donation. As this is a particular issue for charities, apart from the above key principle, the FRS leaves more detailed guidance to the relevant sector-specific guidance and Statements of Recommended Practice (SORPs).

Inalienable, historic and similar assets

8 The Board believes that, in principle, inalienable,* historic and similar tangible fixed assets should be recognised in the balance sheet, to reflect that:

(a) the assets give rise to future economic benefits (although not necessarily in terms of cash inflows),

(b) the entity has stewardship of the assets, and

(c) the entity has invested funds in the assets (through acquisition, maintenance, restoration etc).

* *Inalienable assets are tangible fixed assets that an entity cannot dispose of without external consent.*

9 However, the Board accepts that for some assets that were not capitalised in the past and for some donated inalienable, historic and similar assets, the cost of obtaining a valuation (if indeed a reliable valuation is available) may outweigh the benefit to users of the accounts. In such cases, appropriate disclosures should be made in the notes to the accounts instead. Further guidance is available in the relevant sector-specific guidance and SORPs.

Capitalisation of finance costs

10 The FRS permits the optional capitalisation of finance costs, such as interest. The Board acknowledges that it would be preferable either to prohibit or to mandate the capitalisation of finance costs. Conceptually, directly attributable finance costs should be capitalised, for the following reasons:

(a) finance costs are just as much a cost of constructing the tangible fixed asset as other directly attributable costs.

(b) capitalising finance costs results in a tangible fixed asset cost that more closely matches the market price of completed assets. Treating the finance costs as an expense distorts the choice between purchasing and constructing a tangible fixed asset.

(c) the accounts are more likely to reflect the true success or failure of the project.

11 However, the Board was influenced by the argument that if capitalisation is to become mandatory, in theory notional interest should also be capitalised. This is a contentious issue and until an internationally acceptable approach is agreed, the Board favours maintaining the optional capitalisation of finance costs, which is consistent with the approach in IAS 23 'Borrowing Costs'.

Subsequent expenditure

12 The FRS codifies generally accepted accounting practice that subsequent expenditure on a tangible fixed asset undertaken to ensure that the asset maintains its previously assessed standard of performance (ie 'repairs and maintenance' expenditure) is recognised in the profit and loss account as it is incurred, whereas subsequent expenditure that enhances the previously assessed standard of performance of the tangible fixed asset is capitalised.

13 However, the FRS also recognises that it may be appropriate to capitalise certain subsequent expenditure that would have been written off to the profit and loss account in the past as repairs or maintenance expenditure, but to do so only where the depreciation of the asset already reflects the reduction of the service potential of the asset that has been restored by the expenditure. Where appropriate, tangible fixed assets may be divided into two or more major asset components, each component being treated separately for depreciation purposes and depreciated over its own individual useful economic life. Therefore, when a component is restored or replaced, that expenditure should be capitalised.

14 The decision to record a tangible fixed asset as several different components with different useful economic lives will depend upon the individual circumstances. In practice the Board expects a commonsense approach, so that only significant, major components with substantially different useful economic lives are identified and treated separately for depreciation purposes.

15 Before FRS 12 became applicable, some entities recognised as a provision significant costs of future repairs, maintenance, inspections or overhauls of their tangible fixed assets. Under FRS 12, such future costs are not present obligations of the entity resulting from past events, and therefore no provision should be made for them, even if they are required by legislation if the asset is to continue to be used. In these circumstances, an entity should charge such expenditure to the profit and loss account as it is incurred.

16 Alternatively, the entity may depreciate the relevant part of the asset that is declining in service potential to reflect the need for future repairs, maintenance, inspections or overhauls (ie to take account of the actual consumption of the asset's economic benefits) and to capitalise the subsequent expenditure because it results in the restoration of the asset or replacement of some of its components. This latter approach results in a charge being recognised in the profit and loss account that is similar to what would have been recognised under previous (pre-FRS 12) practices. However, the charge takes the form not of a provision for future expenditure but of depreciation, in recognition of the fact that economic benefits of the asset have been consumed at a different rate from that applicable to the remainder of the asset.

Valuation

Optional valuation

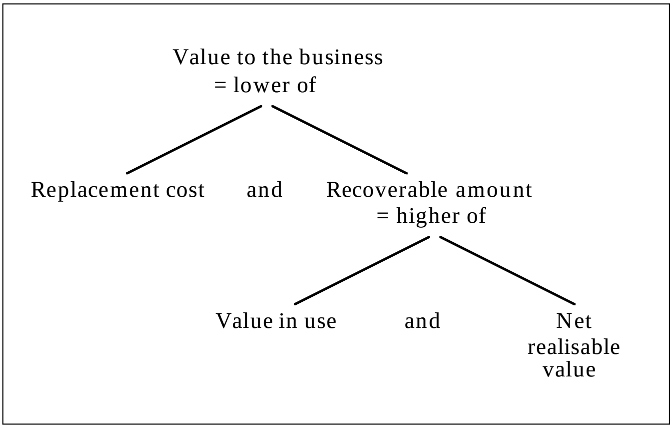
17 The FRS codifies present practice whereby the valuation of tangible fixed assets is optional. By not imposing a requirement either to revalue or not to revalue, the Board is, exceptionally, leaving to individual preparers of financial statements the task of weighing the costs and benefits of the alternative accounting treatments. However, where a revaluation policy is adopted, the FRS imposes conditions to prevent 'cherry-picking' which assets are revalued and when, by requiring up-to-date valuations of all assets in the same class.

Frequency of valuation

18 In determining the guidance in the FRS regarding the frequency of revaluations in paragraphs 43-52, the Board had regard to the views of both the Royal Institution of Chartered Surveyors (RICS) and respondents to the earlier proposals in the Discussion Paper and FRED 17. It has balanced the benefits to users of the financial statements of up-to-date and reliable current values with the cost to preparers of obtaining regular, reliable valuations. This guidance was prepared primarily for commercial entities. Therefore, charities, public sector and other not-for-profit organisations, which have different cost/benefit considerations, may find that different approaches are more appropriate. Alternative guidance may be found in the relevant sector-specific guidance and SORPs.

Basis of valuation

19 As mentioned in the Board's draft Statement of Principles for Financial Reporting, the current value of an asset is determined by reference to the value to the business model. The value of an asset to the business (ie its current value) is the value that is relevant to economic decision-making, ie the loss that the entity would suffer if it were deprived of the asset. This can be portrayed diagrammatically as follows:



20 If the entity is to continue in its existing business at its current volume (or greater), the value to the business of a tangible fixed asset that is used in the business will normally be its replacement cost. As long as the asset is not impaired (in which case recoverable amount would be less than replacement cost), the entity, if deprived of the asset, would replace it with another similar asset for the same use.

21 For non-specialised properties, existing use value (EUV), with the addition of notional directly attributable acquisition costs (where material), is the basis that more closely approaches the concept of replacement cost (ie the least cost of purchasing the remaining service potential of the asset at the date of valuation). Notional directly attributable acquisition costs are included where material, as they form part of the cost to the entity of replacing the asset. EUV reflects the replacement of the service potential that is used by the owner rather than alternative possible uses.

22 Normally EUV will be no greater than open market value (OMV) as the latter reflects the additional possible uses that are ignored in arriving at EUV (for example, a factory located on the edge of an expanding town may have greater value as a potential residential property development than as an industrial site). In most cases, where a non-specialised property is fully developed for its most beneficial use, it is expected that the EUV will equal OMV with vacant possession. However, in some circumstances EUV may be higher than OMV. This may be the effect, for example, of restrictive alienation clauses in headleases, planning consents that are personal to the present occupier, or known contamination that does not affect the existing use of the non-specialised property. All of these would lower OMV, but would be disregarded in determining EUV as they do not affect the cost of replacement. Therefore, the FRS requires further information about OMV in the notes to the financial statements where OMV is materially different from EUV.

23 A concern was raised that in certain limited circumstances EUV may not provide an adequate measure of the replacement cost of a non-specialised property. This was due, in part, to the following two factors:

- When valuing a property with adaptation works (ie structural changes and specialised fittings made to the shell of a property to meet the particular needs of the individual business), both OMV and EUV are often lower than the original cost of the property. This is because the specialised nature of the adaptation works means that they are either not required by other entities or could not be used by them and therefore they are ascribed a low or nil market value.

- In rare cases, an entity may hold an exceptionally large property that because of its size would be unlikely to be purchased in its present state by a single purchaser but might well be of interest to a number of purchasers if it was divided into components. In this situation it is unlikely that evidence of market transactions of similar exceptionally large properties exists.

24 The Board has discussed these issues with the RICS. The first issue may be addressed by treating the adaptation works and shell of the property as separate assets, in accordance with the RICS *Appraisal and Valuation Manual*, Practice Statement 12.4. Because there is no market for the adaptation works they are held at cost or depreciated replacement cost, and the shell of the body (pre-adaptation works) is valued using EUV.

25 For exceptionally large properties, the RICS has indicated that it is prepared to consider amending the commentary to the definition of EUV, to include the potential for breaking up such properties into smaller units.

26 For certain properties no EUV or OMV can be determined, owing to their specialised nature and because they are rarely sold on the open market, except as part of a sale of the business in occupation. Such specialised properties are therefore valued on the basis of depreciated replacement cost.

27 If an entity were deprived of a tangible fixed asset that was surplus to requirements, then it would not replace that asset with another similar asset with the same service potential. In this situation, consistently with the value to the business model, the relevant valuation basis is not replacement cost or value in use, but rather net realisable value. Therefore, the FRS requires properties surplus to requirements to be valued using OMV less any material expected directly attributable selling costs. Selling costs are deducted to reflect the net realisable value of the asset to the entity.

28 Similar valuation bases are to be used for tangible fixed assets other than properties.

Reporting gains and losses on revaluation

29 The Board believes that, in principle, downward revaluations fall into two general groups—those that are clearly caused by a consumption of economic benefits (eg physical damage or a deterioration in the quality of the service provided by the asset) and those caused by a general fall in prices (eg a general slump in the property market). The first type is similar to depreciation and is treated as such, whereas the second type is more like a valuation adjustment that would fall to be recognised in the statement of total recognised gains and losses.

30 When it is obvious that there has been a consumption of economic benefits, the asset is clearly impaired and the loss recognised in the profit and loss account, which is consistent with the treatment in FRS 11 'Impairment of Fixed Assets and Goodwill'.

31 However, in most cases it is difficult to allocate a downward revaluation to one or other group with certainty. In order to provide objectivity in the treatment of revaluation losses, the FRS requires that where there is doubt whether the fall in value is caused by a reduction in the quantum of the service potential, the loss should be recognised in the statement of total recognised gains and losses until the carrying amount of the asset reaches its depreciated historical cost. Any further fall in value should be recognised in the profit and loss account, except to the extent that it can be demonstrated that the tangible fixed asset is not impaired—ie that the recoverable amount exceeds the revalued amount; such a fall is recognised in the statement of total recognised gains and losses instead.

32 Where the type of fall in value is unclear, splitting the revaluation loss between the statement of total recognised gains and losses and the profit and loss account is necessarily arbitrary, because it depends upon whether the fall in value is above or below depreciated historical cost. However, this treatment has the advantage of being consistent with FRS 11, IAS 16 (revised 1998) 'Property, Plant and Equipment' and IAS 36 'Impairment of Assets' (although some other aspects of the treatment of revaluation gains and losses in the FRS are not consistent with IAS 16, as noted in Appendix III 'Compliance with International Accounting Standards').

33 The Board recognises that the treatment of revaluation losses in the frs represents a pragmatic solution and, together with the other members of the G4+1,* is developing the above approach further in connection with its project on reporting financial performance. To this end, the Board, as part of the G4+1, intends to issue later in 1999 a Discussion Paper that will consider the development of a new framework for reporting gains and losses with different characteristics. The Paper will explore the above concepts further and consider ways of refining the approach to revaluation losses. This process may, in due course, lead to revisions to the frs in this area, in conjunction with future developments in the reporting of financial performance and revisions to frs 3 'Reporting Financial Performance'.

34 Revaluation gains are most likely to reflect a general rise in prices and therefore are recognised in the statement of total recognised gains and losses as valuation adjustments. Nevertheless, revaluation gains that reverse previous revaluation losses on the same tangible fixed asset are recognised in the same performance statement (after adjusting for subsequent depreciation) as the revaluation loss it reverses.

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* *The G4+1 is a group of representatives from the standard-setting bodies of Australia, Canada, New Zealand, the UK and the USA, and from the International Accounting Standards Committee.*

Reporting gains and losses on disposal

35 FRS 3 requires gains and losses on disposal to be recognised in the profit and loss account in the period in which the disposal took place, calculated as the difference between carrying amount and the net sale proceeds. This treatment of gains and losses on disposals is inconsistent with the treatment of gains and losses on revaluation. For example, a revaluation gain would be recognised in the statement of total recognised gains and losses, whereas a subsequent gain on disposal would be recognised in the profit and loss account, even though both gains were due to the same factors (ie rising market prices).

36 FRED 17 therefore proposed amending the requirement in FRS 3, so that immediately before recording the disposal of a tangible fixed asset, the carrying amount of the asset would be adjusted to the disposal proceeds and any gain or loss resulting from such an adjustment would be recognised in accordance with the requirements for reporting revaluation gains and losses. Under these proposals those losses on disposal that would be recognised in the profit and loss account are regarded as a form of consumption similar to depreciation. This proposal was to apply to all tangible fixed assets, whether or not a policy of revaluation had been adopted.

37 The responses to FRED 17 made it clear that this proposal was not acceptable at present. Respondents argued that:

- the development of the role of the statement of total recognised gains and losses in FRED 17 was premature, particularly as the direction and outcome of the Board's intended project to review FRS 3 was unclear.

- the proposal raised anomalies for tangible fixed assets held at historical cost. Gains and losses on disposal reflect the accuracy of depreciation policies and estimated residual values, and therefore it was argued that they should be recognised in the same performance statement as depreciation.
- the proposal is inconsistent with the treatment of gains and losses on disposals of businesses, subsidiaries and investments.

38 The Board acknowledges that more work needs to be carried out in this area and intends to revisit this aspect in the course of its review of FRS 3. Accordingly the FRS retains the requirements of FRS 3 for the treatment of gains and losses on disposal.

Depreciation

The objective of depreciation

39 Depreciation is a measure of the cost (historical cost or revalued amount) of the economic benefits of the tangible fixed asset that have been consumed by the entity during the period.

40 It is sometimes argued that a valuation approach to depreciation should be adopted especially where an entity revalues its tangible fixed assets. The Board disagrees with this approach because it does not distinguish between depreciation (ie the amount consumed) and other sources of value changes and therefore results in a reduced or nil depreciation expense in a period of rising prices, even though there is a cost to the entity of using the asset to generate its revenues.

41 The Board does not accept that the increase in the value of a tangible fixed asset justifies non-depreciation. Wherever the asset has a finite expected life, part of the asset representing one year's economic benefits of the asset is consumed in the year. The revenues generated by the entity through using the tangible fixed asset in the business justify a charge to the profit and loss account for using that asset. An increase in value, or an increase in residual value, whether arising from external factors or from refurbishment, should impact only on the parts of the asset representing future economic benefits.

Split depreciation

42 Some have argued that the depreciation charge on a revalued tangible fixed asset should be split, and only that part relating to the historical cost of the asset charged to the profit and loss account. The part of the depreciation charge that corresponds to the revaluation movement would be charged instead to the statement of total recognised gains and losses. Such split depreciation would remove a disincentive to revalue fixed assets and the depreciation charged to the profit and loss account would represent an allocation of the actual cash outlay.

43 The issue of split depreciation raises legal considerations. In Great Britain, paragraph 32(3) of Schedule 4 to the Companies Act 1985* states that:

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* *In Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, paragraph 32(3).*
In the Republic of Ireland, the Companies (Amendment) Act 1986, Schedule, paragraph 20(3).

> "Where sub-paragraph (1) applies in the case of any fixed asset the amount of the provision for depreciation in respect of that asset ... may be the *historical cost amount instead of the adjusted amount, provided that the amount of any difference between the two is shown separately in the profit and loss account or in a note to the accounts*." (emphasis added)

44 It is unclear whether the above-mentioned paragraph permits split depreciation. The Board therefore obtained a legal opinion on this issue. That opinion noted that the practical effect of the paragraph as drafted makes it arguable that the entirety of a given charge need not pass through the profit and loss account. However, the opinion went on to note the implications of the *Marleasing** decision. This case indicates that national courts of EU Member States are under a Community law obligation to interpret national law so that it conforms, so far as possible, with the underlying directive (in this case, the Fourth Directive). Articles 33.3 and 35.1 (c)(cc) of the Fourth Directive prohibit split depreciation.

* *Marleasing S.A. vs La Commercial Internacional de Alimentation S.A. (C-106/89) [1992 CMLR 305].*

45 The Board also considered an alternative method of achieving split depreciation. With this method the full depreciation charge would be included in the profit and loss account along with a credit from the revaluation reserve equal to the depreciation on the revaluation surplus. In Great Britain, section 275(2) of the Companies Act 1985* permits depreciation on a revaluation surplus to be treated as a realised profit and paragraph 34(3) of Schedule 4* permits an amount to be transferred from the revaluation reserve to the profit and loss account if it represents a realised profit. However, total depreciation and the credit from the revaluation reserve would be required to be separately disclosed in the profit and loss account (ie the credit from the revaluation reserve would not be permitted to be offset against the charge for depreciation).

46 The Board disagrees with the introduction of this alternative for three reasons:

(a) It would involve recycling amounts previously recognised in the statement of total recognised gains and losses—ie via a transfer from the revaluation reserve to the profit and loss account. The transfer from the revaluation reserve would result in a charge to the statement of total recognised gains and losses. Such a charge has no meaning.

(b) It is inconsistent with the Board's view of depreciation as a measure of the cost of the economic benefits consumed during the period.

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* *In Northern Ireland, the Companies (Northern Ireland) Order 1986, article 283(2) and Schedule 4, paragraph 34(3).*
In the Republic of Ireland, the Companies (Amendment) Act 1983, section 45(6) and the Companies (Amendment) Act 1986, Schedule, paragraph 22(4).

(c) An approach that recognises depreciation on the historical amount of an asset in the profit and loss account and depreciation on the revalued amount in the statement of total recognised gains and losses implies that the purpose of the profit and loss account is invariably to report historical cost profits and losses. The Board rejected such an objective during its development of FRS 3. In addition, FRS 3 requires a note of historical cost profits and losses where there is a material difference between the results as disclosed in the profit and loss account and the result on an unmodified historical cost basis.

47 The Board believes that depreciation measured at current prices represents the best measure of the operating cost of using the asset in question. This is because the purpose of charging depreciation to the profit and loss account is to show the cost of the economic benefits consumed during the period, and depreciation based on current value reflects the cost that the entity could have avoided if it had not used the asset. In addition, it also provides a consistency between the profit and loss account and the balance sheet and is consistent with companies legislation. Hence, the FRS requires the depreciation charge in the profit and loss account to be based on the revalued amount of the asset, whenever the asset has been revalued.

Non-depreciation of tangible fixed assets

48 There has been a growing trend towards the non-depreciation of certain tangible fixed assets, particularly property. The main circumstances in which it is argued that no depreciation need be charged are where maintenance or refurbishment is carried out regularly, significantly extending the useful economic life of the asset or maintaining the residual value of the asset.

49 The Board believes that the estimate of a tangible fixed asset's useful economic life cannot be extended limitlessly through maintenance, refurbishment, overhaul or replacement of components of the asset. This is because the physical life of a tangible fixed asset, other than non-depreciable land, cannot be indefinite. At some point in time it will not be economic to continue to maintain and restore the asset and it will have scrap value only. Accordingly, the FRS states that subsequent expenditure on a tangible fixed asset that maintains or enhances the previously assessed standard of performance of the asset does not negate the need to charge depreciation.

50 The Board acknowledges that, with regular maintenance and restoration and where economic or technological obsolescence is unlikely, some tangible fixed assets (eg heritage buildings, fine art) may have very long useful economic lives before they need a major refit or restoration or are scrapped. In such cases the periodic depreciation charge may be immaterial.

51 The useful economic life of a tangible fixed asset is defined as the period in which the asset is expected to be used by the entity in its business. Therefore the useful economic life to the entity may be substantially shorter than the asset's total economic life, particularly where the asset management policy of the entity involves the disposal of assets after a specified time or after consumption of a limited portion of the economic benefits embodied in the asset. In addition, the asset may have an alternative use that has a longer economic life. In these circumstances, with regular maintenance and repairs, the residual value of the asset at the end of the useful economic life to the entity, which will reflect the remaining economic value of the asset, may not be insignificant or materially different from the carrying amount of the asset.

52 The Board believes that, apart from non-depreciable land, the only grounds for not charging depreciation on a tangible fixed asset are that the depreciation charge and related accumulated depreciation balance are not material, owing to a long estimated remaining useful economic life or high residual value. By not charging depreciation, however, there is greater risk that recoverable amount will fall below the carrying amount in the future. Where depreciation is not charged, therefore, the FRS requires impairment reviews to be undertaken at the end of each reporting period.

53 Similarly, the longer the useful economic lives assigned to tangible fixed assets, the greater is the risk that the recoverable amounts will fall below the carrying amounts in future. Where a depreciation period exceeds 50 years, the Board believes that the risk is sufficiently high to require depreciation to be supplemented by reviews for impairment at the end of each reporting period.

Review of useful economic life and residual value

54 Changes in the useful economic life or residual value of a tangible fixed asset generally arise from new information or developments and therefore do not relate to past periods. For that reason the FRS requires changes in the useful economic life and residual value of an asset to be accounted for prospectively over its remaining useful economic life. Estimates of residual value should be based on prices prevailing at the date of acquisition or latest revaluation. Unless the asset is being revalued, therefore, the estimate of residual value should not be altered simply because of changing prices.

Changes made following exposure of FRED 17

55 The majority of respondents to FRED 17 were broadly supportive of its proposals, with the exception of the proposals in respect of the treatment of gains and losses on disposal and the consequential amendment to FRS 3, which proved controversial. The Board has accepted the argument that the changes to recognition of gains and losses on disposal should not be introduced in isolation from a review of other aspects of FRS 3. It has, therefore, not incorporated these proposals in the requirements of the FRS, maintaining the treatment in FRS 3, as outlined above.

56 In the light of other comments made by those responding to FRED 17, a number of changes have been made to its proposals. The most significant changes are:

- the exemption of investment properties from the requirements of the FRS. The treatment of investment properties is being considered further by the Board, in tandem with the international project on investment properties. The Board believes that, until this work is complete, it is appropriate to maintain the status quo as set out in SSAP 19 'Accounting for investment properties'.

- the inclusion of an explanatory paragraph explaining that, when valuing a non-specialised property, the adaptation works may be treated separately from the shell of the building.

- the amendment of the requirements for reporting gains and losses on revaluation that reverse previous losses or gains, to take into account subsequent depreciation. This ensures that the requirements are consistent with the equivalent requirements in FRS 11.

- the deletion of the proposed requirement in FRED 17 to disclose in the notes to the financial statements any significant differences between the current value and the carrying amount of properties that are not revalued. The Board agreed with respondents that the requirement in companies legislation to make a similar disclosure in the directors' report was sufficient.

- the addition of a new requirement for impairment reviews to be performed in each reporting period when either no depreciation charge on a tangible fixed asset is made on the grounds that it would be immaterial or the estimated remaining useful economic life of the asset exceeds 50 years. This replaces the proposal in FRED 17 that it should be assumed that the residual value of a tangible fixed asset was materially different from its carrying amount, unless the entity intends to dispose of the asset within about a year from its date of acquisition. The Board accepted respondents' comments that the assumption in FRED 17 did not reflect economic reality in certain circumstances. The new requirement is explained in paragraphs 48-53 above.

- the addition of a new requirement in respect of the use of renewals accounting as a method of estimating the depreciation of infrastructure assets.

- the addition of a requirement to disclose a reconciliation of the movements on the carrying amount for each class of tangible fixed assets. This is consistent with the equivalent requirement in companies legislation, but is repeated in the FRS for those entities that do not fall within the scope of companies legislation, and to ensure that the reconciliation is given for each class of assets adopted for revaluation purposes.

- the removal of the paragraph in SSAP 19 'Accounting for investment properties' that exempts charities with investment properties from following the requirements of SSAP 19, to be consistent with the SORP 'Accounting by Charities' issued by the Charity Commissioners for England and Wales.

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