



MALAYSIAN INSTITUTE
OF ACCOUNTANTS
ACCOUNTANTS: MANAGERS OF VALUE

PROUD HOST:



World Congress
of Accountants 2010

www.wcoa2010kualalumpur.com

FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE

FRSIC Consensus 11

When a Company Changes the Measurement Basis for its Assets which Warrants a Prior Year Adjustment, should the Related Depreciation Charges be Adjusted Retrospectively Based on the Revised Definition of Residual Value in Accordance with FRS 116?

Introduction

FRSIC Consensus 11 "When a Company Changes the Measurement Basis for its Assets which Warrants a Prior Year Adjustment, should the Related Depreciation Charges be Adjusted Retrospectively Based on the Revised Definition of Residual Value in Accordance with FRS 116?" was developed by the Financial Reporting Standards Implementation Committee ("FRSIC") and issued by the Malaysian Institute of Accountants ("MIA" or "Institute") on 31 July 2008.

The Consensus contained herein is issued as part of the Institute's initiatives to promote best practices in compliance with the highest standards in financial accounting.

FRSIC CONSENSUS 11**WHEN A COMPANY CHANGES THE MEASUREMENT BASIS FOR ITS ASSETS WHICH WARRANTS A PRIOR YEAR ADJUSTMENT, SHOULD THE RELATED DEPRECIATION CHARGES BE ADJUSTED RETROSPECTIVELY BASED ON THE REVISED DEFINITION OF RESIDUAL VALUE IN ACCORDANCE WITH FRS 116?**

FRSIC Consensus is guidance issued by MIA and shall be regarded as best practice. It should be read in conjunction with the respective applicable accounting standards.

Members of MIA are expected to observe compliance to the consensus issued. In exceptional circumstances where departure is necessary, members shall be prepared to justify the departure.

FRSIC Consensus need not be applied to immaterial items. Nothing in the FRSIC Consensus is to be construed as amending or overriding the accounting standards or other statements adopted or issued by the MASB and other relevant laws.

The Issue

1. FRS 116₂₀₀₄ "Property, Plant and Equipment" defines residual value of an asset as the net amount which the enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.
2. FRS 116 replaces FRS 116₂₀₀₄ with effect from annual period beginning on or after 1 January 2006 applicable to entities other than private entities as pronounced by the Malaysian Accounting Standards Board.
3. FRS 116 revises the definition of residual value as the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

4. FRS 116₂₀₀₄ paragraphs 54 and 55 allow an entity not to charge depreciation on the grounds of immateriality. An example quoted is when an asset has a high residual value due to regular maintenance and repair to preserve the condition of the asset to its original assessed standard of performance that renders the depreciation charge to be immaterial. These clauses were removed from FRS 116.
5. The issue is in the event that there is a change in the measurement basis of a property, plant and equipment from revaluation model to cost model (which is a change in accounting policy), how should the retrospective application be computed had paragraph 54 and 55 of FRS 116₂₀₀₄ been applied previously. The change in the measurement basis takes place in the first year of adoption of FRS 116.

Consensus and Basis of Consensus

6. The Committee was apprehensive on the rationale for a change in the measurement basis of an asset from revaluation model to cost model. The Committee noted the provisions in FRS 108.14 which states that, an entity shall change an accounting policy only if:
 - i) the change is required by a Standard or an Interpretation; or
 - ii) the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
7. The Committee cautioned that it is rare that a change in measurement basis from revaluation model to cost model will provide more reliable and relevant information in the financial statements.
8. The Committee reviewed the new definition of residual value brought about in the revised FRS 116 and noted that there is no change in the fundamental principles advocated in FRS 116₂₀₀₄. Rather, the revised FRS 116 endeavored to improve and provide better clarification on areas of ambiguity in FRS 116₂₀₀₄.
9. Specifically, Basis of Conclusion (BC) 28 and 29 of FRS 116 provides explanation on the International Accounting Standards Board (IASB)'s intention to make clear the objective of deducting a residual value in determining an asset's depreciable amount.

10. BC 29 clarifies that depreciation is a cost allocation technique and therefore, an entity's expectation of increases in an asset's value because of inflation or otherwise, does not override the need to depreciate it. Accordingly, the definition of residual value has been revised to improve clarity as "the amount an entity could receive currently if the asset was already as old and worn as it will be when the entity expects to dispose it". Thus, any increase in the expected residual value of an asset because of past events will affect the depreciable amount; expectations of future changes other than the effects of expected wear and tear will not.
11. The Committee noted that the underlying principle is consistent with FRS 116₂₀₀₄ and is of the view that the impact will not be materially different had the revised residual value been used as opposed to the preceding residual value in FRS 116₂₀₀₄ or vice versa to effect the retrospective application. In addition, the Committee also observed that the revision in the definition of residual value is of little or no relevance if an entity intends to keep an asset until the end of its useful life when the asset is of no use to anyone else.
12. The Committee further discussed the specific case where an entity had availed itself to FRS 116₂₀₀₄ paragraphs 54 and 55 prior to adoption of FRS 116. It is noted that these paragraphs allow an entity not to charge depreciation on the grounds that the depreciation amount is immaterial due to very long useful life or high residual value. The Committee noted that the residual value would not be materially different prior to and after adoption of FRS 116 as fundamentally, there is no change in the principles brought about by FRS 116.
13. FRS 116.51 requires residual value and the useful life of an asset to be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in accounting estimate in accordance with FRS 108 Accounting Policies, Changes in Accounting Estimates and Errors. The Committee noted that the provision in the standard is clear.
14. Based on the above, the Committee concluded that any revision in the useful life or residual value of an asset is a change in accounting estimates and should be accounted for in accordance with FRS 108. In this regard, the Committee alerted that an entity should comply with the disclosure requirements enunciated in RS 108.39 and FRS 108.40.

Issuance Date of this Consensus

15. This Consensus is issued on July 31, 2008.

References

FRS 116 "Property, Plant and Equipment"

FRS 108 "Accounting Policies, Changes in Accounting Estimates and Errors"