Comment Information

Document Section RICS Valuation - Global Standards 2017 …
1. Valuation ('measurement') for financial s…
UK VPGA 3 Accounting for depreciation a… (no name) ***/***

Comment ID 27

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Comment

UK VPGA 3 Accounting for depreciation and associated apportionments for the purposes of financial statements prepared under UKGAAP (FRS 100-103 and IFRS: IAS 16 and IAS 36)

This is not a title, it's an essay. "Depreciation Accounting" would be sufficient. "Accounting for..." should be avoided as RICS guidance should be on the information the valuer needs to provide to the reporting entity. Accounting for depreciation is the role of the entity or its accountants.

My comments on this UK VPGA are subject to three overriding points:

1. Unlike the current UK Appendix 4, the draft also purports to cover deprecation under IFRS. Guidance on IFRS should be in the Global Red Book, with only any variations under UK GAAP in the UK VPGN. Since there are no material differences to the valuation inputs required for depreciation accounting under either IFRS or UK GAAP, there would be no need for anything in the UK Red Book on this subject. Since the opportunity to provide meaningful guidance on IFRS was missed in the Global update in 2017, as I have suggested previously, the best solution would be to remove material on financial reporting under IFRS from this edition and issue it as freestanding GN with global application, with a relatively modest UK VPGA dealing with any UK variations.
2. I have noted various alterations to the text of UK Appendix 4 in the 2014 edition. While a few are pertinent, most simply add accounting information which is of no relevance to the valuer's role. Some of the new text is poorly written and obfuscates the meaning of the original. It has also resulted in significant repetition of certain principles. Subject to my following overriding comment and the detailed comments below, my recommendation is to revert to the current text.

3. The order in which information appears is not logical and the paragraphs beneath each of the sub headings do not always relate to the subject of the heading. For example, discussion about the useful life appears under the headings “Commentary”, “Depreciation” and “the Depreciable Amount” when they would be better grouped under a heading “Useful Life”. The general organisation could be usefully revisited.

Detailed Comments:

- Throughout the draft reference is made to “useful economic life”. The term in both IAS 36 and FRS 2 is simply “useful life”. Correcting this will also help avoid confusion with the concept of “economic life”.

- The draft (and the current UK Appendix 4) start discussion of matters such as useful life and residual value without first explaining what depreciation is or the relevance of these concepts. I suggest the opening paragraphs should be along the following lines:

> *"Depreciation in a financial reporting context should not be confused with depreciation adjustments made when applying certain valuation methods, for example depreciated replacement cost. In financial reporting, depreciation refers to a charge made against income to reflect the use of the asset over its over its useful life.*
>
> *Components of an asset that have a cost that is significant in relation to the whole are required to be depreciated separately. Components that have a similar useful life and that are depreciated in a similar manner may be grouped.*
>
> *In order to establish the appropriate depreciation charge it is necessary to establish the useful life of the asset (or a component thereof) and the depreciable amount. The*
>
> *depreciable amount is the difference (if any) between the carrying amount and the residual value. These terms are defined in IAS 16 as follows:*
>
> > ***Depreciable amount is*** *the cost of an asset or other amount substituted for cost in the financial statements, less its residual value.*
> >
> > ***Carrying amount*** *is the amount at which an asset is recognised after deducting any accumulated depreciation or amortisation and accumulated impairment losses thereon.*
> >
> > ***Residual value*** *is the estimated amount that an entity would currently obtain from disposal of an 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.*

> ***Useful life** is (a) the period over which an asset is expected to be available for use by an entity, or (b) the number of production or similar units expected to be obtained from the asset by an entity.*

The carrying amount can be based on either historic cost or fair value, less accumulated depreciation and accumulated impairment losses. Whichever is used by the entity, a valuer may be requested to estimate the economic life of the asset, which the entity can use to help determine the useful life or to estimate the residual value."

This could replace 1- 5 in the current draft, although some consequential amendments or reorganisation would be required to later paragraphs, eg para 7 would need deleting, but there is an advantage in explaining and defining the various concepts at the beginning.

- Paragraphs 2-3. These have been added to the existing text but are unhelpful and unnecessary as the treatment of land and buildings is discussed latter in the document.

- Paragraph 5. The two sentences beginning “When assessing the…” which have been added to the existing 1.4 describe criteria for the accounting policy and are of no relevance to the valuer. I recommend reverting to the original.

- Paragraph 7. The second sentence which has been added to the current 1.6 is redundant. If you say a piece of string may be less than one metre long, it is implicit that the maximum allowed length of a piece of string is one metre.

- Paragraph 9. The proposed final sentence, “While routine servicing…”, is a useful addition to the current 2.2.

- Paragraph 10. The words …”reflecting the remaining “…lifespan or design life” which have been added to the current text of 2.3 should be deleted. They are not incorrect, but an addition that explains that the economic life is of assets (components) in situ on the valuation date and that possible future replacement or refurbishment is ignored is unnecessary. These points are covered elsewhere, the second by the amendment to the previous paragraph! The proposed final sentence is also a direct repetition of paragraph 7.

- Paragraph 11. This is guidance on accounting options which are stated to apply only in limited circumstances and have relatively small impact on the useful life. This might get extra marks in an accountancy exam but are of zero relevance to the valuer. Delete.

- Paragraph 15. This is an innocuous statement but begs the question “so what?”. It is usual for valuers to be asked to provide their opinion of the economic life, which the reporting entity then uses to determine the useful life based on its operational plans. This may result in the entity determining a shorter period than the economic life advised by the valuer.

- Paragraph 16. The distinction between the “economic life “which may be determined by a valuer based on market criteria and the entity specific concept of “useful life” used for determining depreciation in accounting is explained in paragraphs 4-7 of the current draft. This is another example of needless repetition. Delete.

- Paragraphs 36-41 introduce a discussion on componentisation. In principle this is a useful addition although the detail needs attention. Paragraph 36 is confusing because an apportionment between land and buildings is made because land and buildings are effectively separate components. Often further apportionment is then required of the building element where elements a) have a cost that is significant in relation to the whole and b) have materially different useful lives. A common example is building heating and cooling services. The additional paragraphs also focus too much on the criteria that the reporting entity should consider in deciding whether components should be depreciated separately. The focus of the VPGN should be on how the valuer deals with a request to, say, apportion the depreciable amount of the building between the fabric and the air-conditioning.

- Paragraph 42. The premise of this paragraph is questionable. As indicated in my comment above on 15, it is more usual for the valuer to provide the economic life and the entity to then make any adjustment required to reflect its useful life, as this will be specific to the entity’s business and policies. While the first four bullet points are all relevant to the assessment of economic life, the fifth is specific to useful life. Since useful life depends on the entity’s business and projections for the asset in question it would be more appropriate to caution the valuer about becoming involved in this. The useful life is something the valuer will have input into but should not be responsible for determining.

- Paragraph 43. This is also based on the inappropriate assumption that the valuer determines the useful life. It also erroneously suggests the valuer may need to seek the assistance of a building surveyor. The valuer’s task is to estimate the economic life, not the physical life, and therefore this should be something within a valuer’s core competence. The suggestion that “banding” will not normally be sufficient is undoubtedly true for determining the useful life as the annual depreciation has to be allocated over a set period. However, since in practice the valuer’s role is to provide the economic life to assist the entity’s calculation of the useful life, it is very common in the case of a complex with many buildings to agree banding, unless a building has a very short economic life, say less than 10 years.