



# Let's get technical

*This column is dedicated to answering questions submitted by members regarding Institute standards*

**Q.** I have a question on utilization of revaluation surplus. I understand that if an entity chooses to account for an item of property, plant and equipment in accordance with HKAS 16 *Property, Plant and Equipment* under the revaluation model, the revaluation surplus included in equity in respect of that asset may be transferred directly to retained earnings when the asset is used by an entity. Under such a scenario, the amount of the surplus transferred is the difference between depreciation charge based on the revalued carrying amount of the asset and the depreciation charge based on the asset's original cost. How should this requirement be applied in practice?

**A.** Paragraphs 41 of HKAS 16 *Property, Plant and Equipment* states that there are two circumstances where the asset revaluation surplus may be transferred to retained earnings:

- The first situation is where the asset is derecognized (that is, when the asset is retired or disposed of), in which the whole or part of the surplus may be transferred; or
- The second situation is where an asset is being used over its useful life, a proportion of the revaluation surplus may be transferred to retained earnings.

You are referring to the second situation. In this case, the amount of the surplus transferred would be equal to the difference between depreciation charge based on the asset's original cost, and depreciation charge based on the revalued amount, adjusted for the tax effect relating to the surplus.

For example, the cost of a property with an estimated useful life of 40 years is HK\$20 million and thus depreciation is calculated as HK\$500,000 per year using a straight-line method.

At the end of year six, the property has a carrying amount of HK\$17 million and a fair value of HK\$25.5 million. The surplus on revaluation of HK\$8.5 million is credited to the revaluation reserve. In order to comply with paragraph 41 of HKAS 16, the revaluation surplus of HK\$8.5 million may be realized over the remaining useful life of the property (that is, in years seven through 40, annual depreciation charge increases by HK\$250,000 and such an amount is transferred directly from revaluation reserve to retained earnings, without recycling through profit or loss), assuming there will be no further revaluation of the property. At the end of year 40, the property will be fully depreciated and the revaluation reserve will be reduced to zero.

It is important to note that the transfers from revaluation surplus to retained earnings are not made through profit or loss. Furthermore, the surplus transfers referred to in paragraph 41 of HKAS 16 are implied to be at the option of the entity, rather than a requirement of HKAS 16.

## Members helping members

*Do you want to help your fellow members? Try answering this question from a member and send an email to [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk). Answers received by 18 July will be considered for inclusion in the September issue of A Plus.*

**Q.** I understand that HKAS 1 (revised) *Presentation of Financial Statements* is effective for annual periods beginning on or after 1 January 2009 with earlier application permitted. In relation to HKAS 1 (revised), I note that a “balance sheet” is now referred to as a “statement of financial position” and a “cash flow statement” is referred to as a “statement of cash flows.” Furthermore, HKAS 1 (revised) introduces the statement of comprehensive income. However, I note that these new titles are not mandatory for use in financial statements. What is your recommendation?

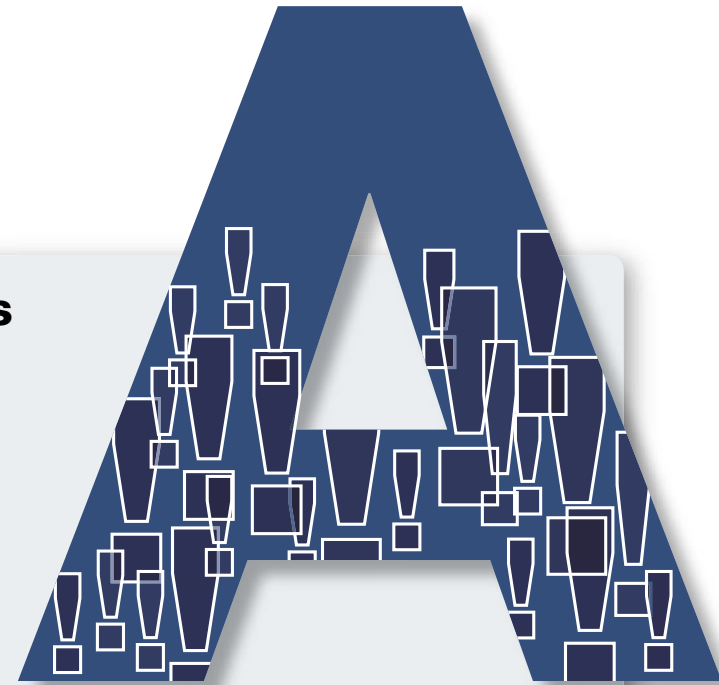
*Here is the answer to the question we asked members to help with in the May 2008 edition of A Plus:*

**Q.** HKAS 39 *Financial Instruments: Recognition and Measurement* requires that transaction costs are included in the initial measurement of financial assets and financial liabilities other than those at fair value through profit or loss. How should this requirement be applied in practice?

**A.** Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument. For financial assets and liabilities, incremental costs that are directly attributable to the acquisition of the asset or incurrence of liabilities, for example fees and commissions, are added to the fair value on initial recognition (unless the financial instrument is at fair value through profit or loss).

The consequences of this are summarized as follows:

(a) For financial instruments that are carried at amortized cost, such as held-to-maturity investments, loans and



receivables, and financial liabilities that are not at fair value through profit or loss, transaction costs are included in the calculation of amortized cost using the effective interest method and, in effect, amortized through profit or loss over the life of the instrument.

(b) For available-for-sale financial assets, transaction costs are recognized in equity as part of a change in fair value at the next remeasurement.

If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortized to profit or loss using the effective interest rate method.

If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life (e.g. the asset is an investment in an equity security and therefore the effective interest rate is not applied), the transaction costs are recognized in profit or loss when the asset is derecognized or becomes impaired.

(c) For financial instruments classified as “at fair value through profit or loss,” transaction costs are recognized immediately in profit and loss.

Further details are available in HKAS 39 – paragraph 43 and IG E.1.

*You can submit questions on technical issues by sending an email to [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk). The standard setting team will answer these questions in accordance with the policy on handling members’ technical questions which is posted on the Institute’s website.*