Examiners interpretation of the impact of a transfer of excess depreciation on the revaluation of an asset

Scenario

An asset has a carrying value of $200,000 and an estimated useful economic life of 20 years at the start of year 1. The asset is revalued to $240,000 at the start of year 1. The applicable income tax rate is 25%.

Accounting treatment

On revaluation the following journal entries are made:

Debit PPE ($240,000 - $200,000)	**$40,000**
Credit Deferred tax liability (25% X $40,000)	**$10,000**
Credit Revaluation reserve	**$30,000**

The $30,000 surplus on revaluation is shown as other comprehensive income in the statement of total comprehensive income.

The accounting entry for the annual depreciation is:

Debit Depreciation expense ($240,000 X 1/20)	**$12,000**
Credit PPE	**$12,000**

The excess depreciation as a result of the revaluation is $2,000 ($12,000 - $200,000 X 1/20). The double entry to record the related transfer from the revaluation reserve to retained earnings is:

Debit Revaluation reserve ($2,000 X 75%)	**$1,500**
Credit Retained earnings	**$1,500**

No adjustment to deferred tax is required as a result of the transfer of excess depreciation. This is because the deferred tax balance is adjusted as a result of the depreciation charge of $12,000 which has reduced the temporary difference.