

TREASURY ANALYSIS - INTERNATIONAL ACCOUNTING STANDARDS

AASB 116 Property, Plant and Equipment replaces AASB 1015 Acquisition of Assets, AASB 1021 Depreciation of Assets & AASB 1041 Revaluation of Non-Current Assets

Major impacts of changes

- Cost of an asset includes both:
 - restoration costs where recognised as a provision under AASB 137; and
 - inspection costs.
- Borrowing costs may be capitalised or expensed, although Treasury has mandated expensing for general government sector entities consistent with GFS/GAAP convergence.
- Impairment of assets is contained in a separate standard, AASB 136.
- Not-for-profit exemptions have been added for Australian purposes.
- Guidance on fair value, frequency of revaluation and accounting for spares has been added¹. This is not part of the standard and, regarding fair value, substantially replicates some material lost from AASB 1041.
- *For-profit entities* must offset revaluation reserve balances on an individual asset basis, rather than on a class basis.
- Additional disclosures for items recognised at fair value.

Key features of standard

AASB116 consolidates and substantially replicates requirements of replaced Australian Standards, except:

- All property, plant and equipment (PP&E) assets are subject to AASB 136 *Impairment of Assets*. Previously, in AASB 1041, impairment was part of the concept of fair value.
- The areas discussed in 'Main Differences' below.

Main differences compared to previous Australian requirements

Recognition

- The asset recognition principles are used to evaluate both initial costs and subsequent costs (AASB 116 para 13). AASB1021 (para 5.7) used different recognition criteria for subsequent expenditures based on whether they added to the future economic benefits "in excess of the originally assessed standard of performance of the existing assets."
- PP&E acquired for safety or environmental reasons are assets because they enable an entity to derive additional economic benefits from related assets (para 11). Australian GAAP did not address this issue.

Measurement

- *Cost* under AASB 116 differs to cost under AASB1041 because of new treatments for restoration costs, major inspection costs, and borrowing costs as discussed below.
- *Restoration Costs*: Cost includes the initial estimate for dismantling, removing and restoring an asset, arising from both:
 - an obligation incurred as a consequence of installing the item; and
 - an obligation incurred as a consequence of using the item during a particular period (para 16(c)).IAS 16 Basis for Conclusions para BC 16 notes that the above applies whether assets are measured at cost or revalued amount. Previous accounting standards did not address this issue. AASB 137 *Provisions* notes that provisions include both legal or constructive obligations (AASB 137 para 7 et al).

¹ However, this Guidance has subsequently been omitted by the AASB.

- *Major inspections* (para 14):
 - The cost of major inspections for faults is recognised in the carrying amount of an asset as a replacement, if the recognition criteria are satisfied (regardless of whether the cost of an inspection was initially identified when the item was acquired or constructed).
 - The remaining carrying amount of the previous inspection (as distinct from physical parts) is derecognised.
 - The estimated cost of a future inspection may be used to estimate the cost of the inspection component when the item was acquired or constructed.
- *Borrowing Costs*: Interest incurred for a self-constructed asset may be capitalised or expensed based on AASB 123 *Borrowing Costs*. Treasury has mandated expensing for general government sector entities. PTEs may choose either option.
- *Cost of acquisition of PP&E in exchange for non-monetary assets or in combination with monetary assets*. Cost of such an acquisition is measured at fair value, unless either the transaction lacks commercial substance or neither the fair value of assets received nor given up is reliably measurable (para 24). Commercial substance of a transaction is discussed at para 25. AASB 1015 assumed that fair value could always be measured.

Fair Value

- Assets may be measured at fair value “where fair value can be reliably measured” (para 31).
- Fair value is discussed but only very briefly. Fair value is determined:
 - from market-based evidence; or
 - by using an income or depreciated cost approach (paras 32-33).
- However, additional “Guidance”¹ is provided on fair value, frequency of revaluation and accounting for spare parts. This guidance is not part of the standard, but it replicates some of what was in AASB 1041.
- On revaluation, either the ‘gross restatement’ or the ‘net amount’ method (where accumulated depreciation is eliminated) may be used (para 35). Conversely, AASB 1041 para 5.7 allowed the gross restatement method only where assets are valued by reference to values of assets newer than those being revalued. Treasury has mandated ‘gross restatement’, where an entity revalues depreciable assets by reference to current prices for assets newer than those being revalued, and adjusts those amounts to reflect the present condition of the asset (TPP 05-3).
- AASB 136 *Impairment of Assets* deals with impairment of assets separate to AASB 116. Previously, under AASB 1041, impairment (or the recoverable amount test) was seen to be part of fair value. This is theoretically more correct, but the change has no practical effect.

Assets and parts of assets

- AASB 116 does not prescribe the unit of measure for recognising assets, that is, what constitutes an item of PP&E. Therefore, judgement is required to apply the recognition criteria to an entity (para 9). There is discussion regarding parts of assets, but parts of assets are not separate assets. Previously, AASB 1021 para 5.7.3 required ‘components’ to be accounted for as ‘separate assets’.
- However, it notes that parts of some assets may require replacement (para 13) and requires the following:
 - the cost of replacing a part of an item shall be recognised in the carrying amount of the item (para 13);
 - the replaced part must be derecognised regardless of whether it had been depreciated separately (para 70); and
 - each part of an item of PP&E with a cost significant in relation to the total cost of the item shall be depreciated separately (para 43).

Impact on the public sector

Granted Assets

- *Not-for-profit entities* shall measure assets acquired at no or nominal cost at fair value (and this is not a revaluation) (para Aus15.1).

- *For-profit entities* shall initially measure PP&E at cost (AASB 116 para 15). This means that a granted item of PP&E is recognised at nil value, except when another Standard requires or permits a different accounting treatment (para 2). AASB 120 para 23 requires a different treatment and states that non-monetary government grants are valued at fair value. An IASB project is underway to amend IAS20 to apply the approach to grants in IAS41. IAS41 does not explicitly address valuing a non-monetary grant. Also, similar to the current AASB 120, UIG 1017 requires an entity to recognise developer contributions at fair value. In both of these instances, the more specific requirements of AASB 120 and UIG 1017 prevail over AASB 116 (AASB 116 para 2).

Revaluation Reserves

- *For-profit entities* must account for revaluation reserve balances on an individual asset basis. This is a change from AASB 1041 which permits the ‘class of asset’ approach. This change could have a negative impact on unappropriated profits. However, as discussed above, AASB 116 does not prescribe the unit of measure for recognising assets, that is, what constitutes an item of PP&E. Therefore, an asset, not a part of an asset, is the basis for accounting for movement in the asset revaluation reserve. However, *not-for-profit entities* may continue to use the class of asset approach (para 39 & 40).

Disclosures for revalued assets (para 77)

AASB116 requires more disclosures for items of PP&E measured at a revalued amount, as follows:

- The methods & significant assumptions applied (vs methods in AASB1041 para 7.19a).
- A split of fair value between: the amount determined by observable prices in an active market, recent market transaction, and the amount estimated by using other techniques.
- *For-profit entities* must disclose, for each class, the amount that would have been recognised under the cost method (para 77(e)). But *not-for-profit entities* are exempted from this disclosure (para Aus77.1).

Policy and Implementation issues (see attached)

Policy and Guidance

- AASB 116 covers fair value even more briefly than AASB 1041. Australian Guidance¹ is provided but this is not part of the standard, and it too is still brief. Therefore, Treasury’s policies on capitalising and valuing PP&E have been amended to give additional guidance (refer TPP 05-3 and TPP 06-6). However, there are few substantive differences, except regarding inspection costs, restoration costs and accounting for revaluations for individual assets for for-profit entities.

Mandating Options

- For NSW public sector, policies have been mandated in most cases where options exist as attached.

Implementation Issues

- Data and therefore systems changes will be needed to identify significant parts of assets for depreciation.
- *For-profit entities* will require information to restate the asset revaluation reserve retrospectively based on an asset (not class basis) for offsetting increments and decrements, unless the deemed cost option is adopted (see Transitional provisions below).

AASB 1 Transitional Provisions

Briefly, AASB 1 “*First Time Adoption of Australian Equivalents to International Financial Reporting Standards*” (AEIFRS) requires adjustment for differences between GAAP and AEIFRS to be adjusted against equity from the date of transition (i.e. 1 July 2004 for 30 June year end entities), except in limited instances. Adjustments may be needed for both PP&E and the related asset revaluation reserve. However, adjusting the asset revaluation reserve can be eliminated by electing that fair value at the date of transition is also ‘deemed cost,’ as discussed below.

NSW Treasury will continue to mandate the fair value revaluation option for PP&E under AASB 116. Therefore, agencies will be required to assess whether there is a material difference between the carrying amount and the fair value of items of PP&E at the date of transition (AASB 116, para 31).

Then, any differences at the date of transition between fair value under ‘previous GAAP’ and fair value under AEIFRS must be adjusted against retained earnings. Adjustments may be required for borrowing costs (where Treasury has mandated expensing previously capitalised amounts), restoration costs and major inspection costs, if the difference is material. Treasury believes that in most instances, these differences will be immaterial. However, agencies will need to demonstrate this.

Adoption of fair value at the date of transition also requires adjustments for any differences in the asset revaluation reserve (except where fair value at the date of transition is taken to be the ‘deemed cost’ (see below)). This requires cost information, which is also necessary for disclosure purposes (for-profit entities only). Differences in the asset revaluation reserve under AEIFRSs compared to previous GAAP may arise because of the following (as discussed above):

- borrowing costs, restoration costs and inspection costs
- changes to restate the asset revaluation reserve of ‘*for-profit entities*’ based on an asset basis.

AASB 1 includes limited exemptions from retrospective application, including the deemed cost option for PP&E, which may be used for PP&E even where an entity elects to apply fair value. It permits an entity to elect to measure an item of PP&E at the date of transition at its fair value and use that fair value as its deemed cost at that date. (Refer AASB 1, para 16). Alternatively, an entity may elect to use a previous GAAP revaluation at, or before, the date of transition as deemed cost at the date of the revaluation, if the previous revaluation was broadly comparable to fair value (refer AASB 1, para 17) ie the valuation methodology is comparable.

For *for-profit entities*, using a previous GAAP revaluation as deemed cost is beneficial because the asset revaluation reserve is retained. In contrast, the disadvantage of adopting fair value at the date of transition as deemed cost, is that the asset revaluation reserve is reset to zero, which means that future asset valuation decrements would hit the operating statement because there is no asset revaluation reserve to offset against.

Therefore, NSW Treasury has mandated the deemed cost option for for-profit entities only, based on a previous GAAP revaluation at the date of corporatisation or at the date of establishment (refer NSWTC 06/14). This means that the asset revaluation reserve must be restated to comply with the AASB 116 requirement for for-profit entities to offset asset revaluation increments and decrements on an individual asset basis, rather than on a class basis.

For *not-for-profit entities*, there is no benefit to the deemed cost option because they will continue to be permitted to offset asset increments and decrements on a class basis.

This summary has been written in general terms and is intended for general reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

**SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 116 “PROPERTY, PLANT AND EQUIPMENT”
TREASURY & AGENCIES**

	Issue	Treasury Policy		System/ Implementation Issue	Mandate Options for GFS Harmonisation	Budget/ Total State Sector Issues
		Mandate Option	Additional Guidance			
1	Cost or fair value option	√ fair value	√		√ fair value	√
2	Fair value guidance		√			
3	Capitalise or expense borrowing costs option	√ expense for GGS agencies		√ identify amount	√ expene	√
4	Restoration costs		√	√		
5	Major inspection costs		√	√		
6	Gross or net restatement option	√ gross for RC				
7	<i>For-profit entities</i> must account for asset revaluations changes on an asset (not class) basis.		√	√		
8	ARR may be transferred to retained earnings on derecognition or progressively	√ mandate transfer on derecognition				
9	Deemed cost option for ‘transition’, either fair value at date of transition or previous GAAP revaluation i.e. at corporatisation or establishment	√ deemed cost, for for-profit entities only, based on previous GAAP revaluation	√	√		
10	Unit of measure		√			