Institute of Chartered Accountants of New Zealand

FINANCIAL REPORTING STANDARD NO. 3
2001

ACCOUNTING FOR PROPERTY, PLANT AND EQUIPMENT

Issued by the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand

Approved on 2 March 2001 by the Accounting Standards Review Board under the Financial Reporting Act 1993

This Financial Reporting Standard is a regulation for the purposes of the Regulations (Disallowance) Act 1989

CONTENTS

This Financial Reporting Standard replaces SSAP-28: Accounting for Fixed Assets (1991) and parts of SSAP-3: Accounting for Depreciation (1984), although SSAP-28 and the relevant parts of SSAP-3 will continue to apply to general purpose financial reports until an entity elects to comply with this Standard as permitted by the Financial Reporting Act 1993 section 27(7), or until this Standard takes effect, whichever is sooner.

This Financial Reporting Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting issued by the Council, Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board has approved FRS-3: Accounting for Property, Plant and Equipment, for the purposes of the Financial Reporting Act 1993, to apply to the following entities (as respectively defined in the Act): All reporting entities and groups, the Crown and all departments, Offices of Parliament and Crown entities, and all local authorities.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with:

(a) accounting for items of property, plant and equipment under the historical cost and modified historical cost systems of accounting;

(b) accounting for the consumption or loss of economic benefits embodied in items of property, plant and equipment.

1.2 This Standard addresses a wide range of items of property, plant and equipment including land and buildings, roads, machinery, telecommunications equipment and electricity networks, but excludes the items of property, plant and equipment and activities listed in paragraph 2.3 of this Standard.

1.3 Items of property, plant and equipment are often a major portion of the total assets of an entity and are therefore significant in the presentation of its financial position. Furthermore, the determination of whether expenditure on an item of property, plant and equipment represents an asset or an expense can have a significant effect on an entity's financial report.

1.4 Under the historical cost system of accounting, items of property, plant and equipment are recognised using cost as their gross carrying amounts. However, many entities recognise changes in the value of these items, especially land and buildings, while retaining other features of the historical cost system of accounting. This is usually referred to as the modified historical cost system of accounting. Recognising changes in the value of items of property, plant and equipment is considered to provide relevant information to users of financial reports.

1.5 Recognition of the consumption or loss of economic benefits embodied in items of property, plant and equipment can have a significant effect on the financial position and financial performance of an entity. The consumption of economic benefits is usually recognised by means of systematic charges made over the useful life of an item of property, plant and equipment. These charges are referred to as depreciation.

1.6 Financial Reporting Standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretative commentary paragraphs in plain type-face follow the Financial Reporting Standard.

2 APPLICATION

STANDARD

2.1 This Standard applies to the general purpose financial reports of all entities except where exempted by paragraph 2.2.

2.2 An entity that qualifies for differential reporting exemptions in accordance with the *Framework for Differential Reporting* may choose to adopt any of the following exemptions from the requirements of this Standard:

(a) In respect of those items of property, plant and equipment accounted for under the historical cost system of accounting, the entity may adopt the rates of depreciation applicable for income tax purposes. If this exemption is taken, the entity is not required to comply with the requirements of paragraphs 8.16 and 8.19 of this Standard.

(b) The entity is not required to comply with paragraph 5.24 of this Standard. If this exemption is taken, the entity must expense all borrowing costs as incurred.

(c) The entity is not required to disclose the information denoted with an asterisk in this Standard.

2.3 This Standard does not deal with accounting for:

(a) self-generating and regenerating assets such as forests and livestock that are held for the purpose of yielding produce for consumption or processing;

(b) expenditure on mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative natural resources;

(c) investment properties and properties intended for sale, which are addressed in SSAP-17: *Accounting for Investment Properties and Properties Intended for Sale*.

2.4 The requirements of this Standard apply to the accounting by lessees of items of property, plant and equipment subject to finance leases in accordance with SSAP-18: *Accounting for Leases and Hire Purchase Contracts*. For the purposes of application of this Standard, items of property, plant and equipment subject to finance leases in accordance with SSAP-18 are deemed to be items of property, plant and equipment of the lessees.

COMMENTARY

2.5 Items of property, plant and equipment subject to operating leases in accordance with SSAP-18 are accounted for by lessors in accordance with this Standard because such items meet the definition of property, plant and equipment. However, this Standard also applies to the accounting by lessees for items of property, plant and equipment subject to finance leases in accordance with SSAP-18. For the purpose of accounting by a lessee under this Standard for an item of property, plant and equipment leased under a finance lease, the present value of the minimum lease payments at the inception of the lease represents the cost of the asset where this amount is lower than the fair value of the leased property at the inception of the lease.

2.6 With the exception of the accounting by lessees for items of property, plant and equipment subject to finance leases in accordance with SSAP-18, this Standard does not apply to intangible assets because intangible assets do not meet the definition of property, plant and equipment. However, intangible assets arising from the rights to use or occupy tangible assets, in addition to those arising under finance leases in accordance with SSAP-18, may also provide substantially the same service potential or economic benefits as assets subject to this Standard. Such other rights to use or occupy tangible assets may arise, for example, in circumstances where a tertiary institution has rights to occupy buildings. Despite the fact that this Standard does not apply to those circumstances, it is appropriate that such rights also be accounted for in accordance with the principles contained in this Standard.

STANDARD

2.7 The Financial Reporting Standards set out in this Standard apply to all financial reports where such application is of material consequence. A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial report is completed, is likely to influence the users of the financial report in making decisions or assessments.

2.8 Subject to paragraphs 12.1 and 12.11 of this Standard, this Standard applies to general purpose financial reports covering periods ending on or after 31 March 2002.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purposes of this Standard are to:

(a) prescribe methods to be followed in accounting for items of property, plant and equipment under the historical cost and modified historical cost systems of accounting;

(b) require recognition of the consumption or other loss of economic benefits (depreciation and impairment losses) embodied in items of property, plant and equipment;

(c) specify minimum disclosures in respect of items of property, plant and equipment.

4 DEFINITIONS

STANDARD

4.1 "Borrowing costs" are interest and other costs incurred by an entity in connection with the borrowing of funds.

COMMENTARY

4.2 Borrowing costs include:

(a) interest on bank overdrafts, short- and long-term borrowings;

(b) amortisation of discounts and premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) the cost of hedging contracts entered into, including the forward point differential at inception of the hedging arrangement.

4.3 Borrowing costs do not include exchange differences arising on foreign currency borrowings except as provided in paragraph 4.2(d) of this Standard.

STANDARD

4.4 "Capitalisation" is the process of including incurred costs in the carrying amount of an asset. "Capitalised" has a corresponding meaning.

4.5 "Carrying amount" is the amount at which an asset or liability is included in the statement of financial position.

COMMENTARY

4.6 In relation to this Standard, the carrying amount of an item of property, plant and equipment will be determined after deducting from the gross carrying amount any accumulated depreciation and any accumulated impairment losses.

STANDARD

4.7 “Class” is a category of assets or liabilities that have a similar nature or function in the operations of the entity.

COMMENTARY

4.8 Examples of a class of items of property, plant and equipment may include all of an entity’s plant (i.e. items of a similar nature), or all of the components of a sewerage system (i.e. items of a similar function).

STANDARD

4.9 “Depreciable amount” is the gross carrying amount of an asset less its residual value.

4.10 “Depreciated replacement cost” is a method of valuation that is based on an estimate of:

(a) in the case of property:
  - **(i) the fair value of land; plus**
  - **(ii) the current gross replacement costs of improvements less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity;**

(b) in the case of plant and equipment, the current gross replacement cost less allowances for physical deterioration, and optimisation for obsolescence and relevant surplus capacity.

COMMENTARY

4.11 Fair value is defined in paragraph 4.23 of this Standard. Depreciated replacement cost is an acceptable estimate of the fair value of an asset only where the fair value of the asset is not able to be reliably determined using market-based evidence. In the case of property, market-based evidence might exist concerning either the land component or the property in aggregate. Depreciated replacement cost is used as an estimate of the fair value of property only where the fair value of the property in aggregate cannot be reliably determined using market-based evidence.

4.12 In the context of this Standard, depreciated replacement cost is based on the reproduction cost of a specific asset. In principle, it reflects the service potential embodied in the asset. However, in some cases, the reproduction cost of the specific asset is adjusted for optimisation in determining depreciated replacement cost.

4.13 Optimisation refers to the process by which a least cost replacement option is determined for the remaining service potential of an asset. This process recognises that an asset may be technically obsolescent or over-engineered, or the asset may have greater capacity than that required. Hence optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity.

4.14 Obsolescence may arise from factors such as outmoded design and functionality of an asset and changed code requirements preventing reconstruction of an asset in its current form. In determining depreciated replacement cost, optimisation for obsolescence is made by reducing the reproduction cost of the specific asset held to the cost of a modern equivalent asset that provides equivalent service potential to that of the specific asset held.

4.15 Surplus capacity may arise from either over-design or from surplus components of an asset. In determining depreciated replacement cost, optimisation is applied only to surplus capacity that is not required currently and for which there is no reasonable prospect it will ever be required in utilising an asset in its current form. Optimisation is not applied to surplus capacity that, while rarely or never used, is necessary for stand-by or for safety purposes.

4.16 In determining depreciated replacement cost, the extent of any reduction in value for surplus capacity subject to optimisation depends on whether that surplus capacity has an alternative use to the current use of the asset. Where there is no alternative use, the optimised value of the surplus capacity is zero. Where there is an alternative use, the optimised value of the surplus capacity is the value of the highest and best alternative use of that capacity.

4.17 To illustrate the distinction described in paragraph 4.16 between surplus capacity not having an alternative use to the current use of the asset and that which does, consider the following example. Assume depreciated replacement cost is to be determined for a network of water pipes where the pipe diameter is greater than currently required or ever expected to be required (including that necessary for stand-by or for safety purposes). There is also a discrete segment of the piping network that is similarly not required for the current use of the asset but which can be closed off and used for other purposes, such as a liquid storage facility. In this case, the surplus diameter of the piping would be disregarded for valuation purposes but the surplus segment of the piping network would be valued at its highest and best alternative use.

4.18 In most cases, surplus capacity subject to optimisation is expected to be disregarded in determining the depreciated replacement cost of an asset. Such surplus capacity is unlikely to have an alternative use unless it is physically and operationally separable from the required capacity.

4.19 In determining depreciated replacement cost, optimisation for obsolescence and relevant surplus capacity is applied only to the extent that it reflects the most probable use of the asset that is physically possible, appropriately justified, legally permissible and financially feasible.

4.20 As evident from the definition of depreciated replacement cost, optimisation is applied only in determining the depreciated replacement cost of plant and equipment and in determining an estimate of the value of the improvements component of the depreciated replacement cost of property. Optimisation is not applied in determining the value of the land component of the depreciated replacement cost of property. The value of the land component will always reflect the fair value of the actual land held, in terms of both its size and location.

4.20A In instances where the land is underutilised, the fair value of the land will be determined by reference to the highest and best use of such land. For example, in a case where specialised manufacturing facilities are located in a prime central business district site but the operation would be able to be run from a smaller sized and less valuable alternative site offering the same service potential, the fair value of the land would be the open market value of the entire central business district-located site.

4.21 An amount equal to the amount of borrowing costs that would be embodied in the fair value of the asset is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of depreciated replacement cost is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation in accordance with section 5 of this Standard. The amount to be included as a component of depreciated replacement cost is determined on the basis of the average debt to equity ratio and average cost of debt applicable to entities within the same industry as the entity reporting.

STANDARD

4.22 "Depreciation" is the measure of the consumption of the economic benefits embodied in an asset whether arising from use, the passing of time or obsolescence.

4.23 "Fair value" is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

COMMENTARY

4.24 Other terms commonly used to describe fair value include "market value", "open market value" and "current market value".

4.25 The fair value of an asset is the exchange amount, as described in paragraph 4.23, at the operative date. The fair value of an asset is determined by reference to its highest and best use, that is, the most probable use of the asset that is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value.

4.26 Where the fair value of an asset is able to be determined by reference to the price in an active market for the same asset or a similar asset, the fair value of the asset is determined using this information. Where the fair value of an asset is not able to be determined in this manner, the fair value of the asset is determined using other market-based evidence, such as by a discounted cash flow calculation using market estimates of the cash flows able to be generated by the asset and a market-based discount rate. Where fair value of the asset is not able to be reliably determined using market-based evidence, depreciated replacement cost is considered to be the most appropriate basis for determination of fair value. This situation will usually only arise where an asset is specialised or the only transaction price evidence arises in a monopoly context.

4.26A The fair value of land would normally be determined from market based evidence. However, in the rare instances where extensive works have been carried out in order to prepare land for use in the entity's business, available market evidence will normally relate to land of the same size and in the same general vicinity but which is priced for uses that are sub-optimal relative to the use for which the works were carried out. In these rare instances the fair value of the land should be determined by having regard to the replacement cost of the land. For example, consider the case where an airport or port company acquires a section of seabed, fills it in and builds a seawall in order to produce flat land for use in the entity's business. The reclaimed land is in the precise location where the entity requires land. Market evidence may exist for other land of the same size and in the same general vicinity as the reclaimed land, but that other land is not suitable for the use intended by the entity. Thus, the market evidence on the fair value of that other land is not relevant to the reclaimed land, and the best indicator of the fair value of the reclaimed land would be the replacement cost of that land. Land resulting from extensive works by a local or central government body in constructing new roading provides a similar example.

4.27 Most items of property, plant and equipment are able to be sold in their own right, and market-based evidence of fair value for these items will often be readily available. Examples of such items include motor vehicles, shops, office blocks, industrial complexes, churches, police stations and post offices.

STANDARD

4.28 The term “future economic benefits” is synonymous with the term “service potential”.

COMMENTARY

4.29 This Standard uses the term “future economic benefits”. However, this term is to be read as having the same meaning as the term “service potential”.

4.30 Although measured in financial terms, future economic benefits are not necessarily represented by cash flows; for example, the future economic benefits represented by a public library are primarily the benefits enjoyed by those who use the library.

STANDARD

4.31 “Gross carrying amount” of an item of property, plant and equipment is the amount at which the item is included in the financial statements before deducting accumulated depreciation and accumulated impairment losses.

4.32 “Impairment loss” is the amount by which the carrying amount of an asset exceeds its recoverable amount.

4.33 “Net market value” is the fair value at a particular date less the costs of disposal that could reasonably be anticipated at that date.

COMMENTARY

4.34 In determining net market value it is not appropriate for the costs of disposal to be discounted because they will already be expressed as a current value. Other terms commonly used to describe net market value are “net current value” and “net realisable value”.

STANDARD

4.35 “Property, plant and equipment” are tangible assets that:

(a) are held by an entity for use in the production or supply of goods and services, for rental to others or for administrative purposes, and may include items held for the maintenance or repair of such assets; and

(b) have been acquired or constructed with the intention of being used on a continuing basis.

COMMENTARY

4.36 SSAP-17: *Accounting for Investment Properties and Properties Intended for Sale* includes within the definition of investment properties, property held primarily for rental. Confusion could therefore arise as to whether property held by an entity for rental to others is to be accounted for in accordance with this

Standard, or in accordance with SSAP-17. Professional judgement is required to determine which Standard is more appropriate. The following property will generally be accounted for in accordance with this Standard:

(a) property held for short-term rental where the entity is actively managing that property;

(b) property whose rental is directly linked to the risks and rewards of the business being operated from that property.

Other property, including property held primarily for capital growth, is to be accounted for in accordance with SSAP-17. Thus hotels are normally accounted for in accordance with this Standard, whereas shopping centres and office blocks are normally accounted for in accordance with SSAP-17.

4.37 Some items of property, plant and equipment are commonly described as “infrastructure assets”. Infrastructure assets meet the definition of property, plant and equipment and are to be accounted for in accordance with this Standard. Infrastructure assets usually show some or all of the following characteristics:

(a) they are part of a system or network that could not operate if one component were removed;

(b) they comprise large numbers of components having different useful lives or providing benefits in different patterns;

(c) they enable the provision of essential services, seen as necessary to sustain living standards;

(d) they are specialised in nature and do not have alternative uses;

(e) they are immovable;

(f) they are subject to constraints on disposal.

These characteristics are not confined to infrastructure assets, nor are infrastructure assets confined to the public sector.

4.38 Some resources are described as “heritage assets” because of their cultural or historical significance. Heritage assets that meet the definition of property, plant and equipment are to be accounted for in accordance with this Standard.

4.39 Determining whether an item of property, plant and equipment that incorporates both intangible and tangible components should be accounted for in accordance with this Standard requires judgement to assess which component is more significant. For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment; the same applies to the operating system of a computer. Even though an asset may not meet the definition of property, plant and equipment because its tangible component is not the more significant component, an application of the principles contained in this Standard may nonetheless be appropriate.

STANDARD

4.40 "Recoverable amount" is the greater of:

(a) net market value; and

(b) value-in-use.

4.41 "Residual value" is the net amount that the entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal, to the extent that such costs have not been capitalised as part of the cost of the asset.

COMMENTARY

4.42 The estimate of residual value of an item of property, plant and equipment is based on the net amount that could be recovered for similar items that have reached the end of their useful lives and that have operated under conditions similar to those under which the acquired item will operate. The estimate of residual value is expressed in terms of the amount expected as at the date of making the estimate, for example, as at the date of acquisition, construction or revaluation, and is not some future value that takes into account the effect of inflation.

4.43 The expected costs of disposal may include site restoration costs or other costs that are capitalised as part of the cost of the asset. Such costs should not be taken into account in the estimate of residual value. If the effect of such costs were taken into account, the depreciable amount, and hence the recognition as an expense of the consumption of service potential over the life of the asset, would differ between assets for which the expected costs of disposal have been capitalised and assets for which they have not.

STANDARD

4.44 "Revaluation" means recognition in the financial statements of an upwards or downwards valuation of an asset at a particular date subsequent to its acquisition or construction.

4.45 A "revaluation deficit" is the net decrement that arises, in respect of a class of assets, when the accumulated sum of all revaluation decrements recognised in the financial statements exceeds the accumulated sum of all revaluation increments recognised in the financial statements. The accumulated sum of revaluation decrements excludes revaluation decrements that have been previously recognised in the statement of financial performance to the extent that those decrements have not been offset by revaluation increments that have been subsequently recognised in the statement of financial performance.

4.46 A "revaluation surplus" is the net increment that arises, in respect of a class of assets, when the accumulated sum of all revaluation increments recognised in the financial statements exceeds the accumulated sum of all revaluation decrements recognised in the financial statements.

COMMENTARY

4.47 The revaluation deficit and the revaluation surplus are the same amounts, respectively, as the debit or credit balance of an asset revaluation reserve for a class of assets, if such a reserve is maintained. Therefore, the revaluation deficit and the revaluation surplus exclude revaluation increments or decrements relating to assets that have been disposed of or permanently withdrawn from the class. The revaluation deficit also excludes revaluation decrements that have been previously recognised as an expense in the statement of financial performance and not subsequently reversed.

STANDARD

4.48 "Useful life" is either:

- **(a) the period of time over which the future economic benefits embodied in an asset are expected to be consumed by the entity; or**
- **(b) the total service, expressed in terms of production or similar units, expected to be obtained from an asset by the entity.**

COMMENTARY

4.49 The useful life of an item of property, plant and equipment is entity specific. An entity's asset management policy may involve the disposal of items of property, plant and equipment after a specified period of time or after consumption of a certain proportion of the economic benefits embodied in the item. Where there is a planned and expected disposal of an item of property, plant and equipment before the expiry of its total life, the useful life will be shorter than its total life. However, in such a case, the residual value will reflect the position that the economic benefits embodied in the asset will not have been totally consumed. A determination of the useful life of an item of property, plant and equipment is a matter of judgement based on the experience of the entity with similar items.

4.50 The following factors need to be considered in determining the useful life of an item of property, plant and equipment:

- (a) the expected usage of the item by the entity, assessed by reference to the item's expected capacity or physical output;
- (b) the expected physical wear and tear on the item, which will depend on operational factors; for example, for machinery these factors would be the number of shifts for which the machinery is to be used, the entity's repair and maintenance programme, and the care and maintenance of the machinery while idle;

(c) technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the item;

(d) legal or similar limits on the item's use, such as the expiry dates of consents granted under the Resource Management Act 1991, taking into account the period of any renewals or extensions that are probable.

4.51 In estimating the useful life of an item of property, plant and equipment, expected ongoing maintenance is to be taken into account. However, any future expenditure that is likely to increase the level of economic benefits embodied in the item beyond that most recently assessed, and that would therefore be capitalised in accordance with paragraph 6.1(a) of this Standard, is not to be considered in determining the useful life of the item before the expenditure is incurred.

4.52 Land usually has an unlimited useful life and is therefore not normally depreciated. A building has a limited life and is therefore depreciated. An increase in the value of the land on which a building stands does not affect the determination of the useful life of the building.

4.53 It is very rare for items of property, plant and equipment other than land to have unlimited useful lives. Although some infrastructure networks may appear to have unlimited lives, this is achieved only by the regular renewal of the major components of the networks, which have limited (although sometimes indeterminable) useful lives. Some heritage assets, such as archives, art works, and museum collections, may have very long but not unlimited useful lives.

STANDARD

4.54 "Value-in-use" is the present value of the net future cash flows obtainable from an asset's continuing use and ultimate disposal.

COMMENTARY

4.55 Estimating the value-in-use of an item of property, plant and equipment involves:

(a) estimating the future cash inflows and outflows to be derived from continuing use of the item and from its ultimate disposal;

(b) determining an appropriate discount rate.

FINANCIAL REPORTING

5 INITIAL RECORDING OF PROPERTY, PLANT AND EQUIPMENT

STANDARD

5.1 An item of property, plant and equipment that meets the asset recognition criteria must be recognised in the statement of financial position.

COMMENTARY

5.2 *The Statement of Concepts for General Purpose Financial Reporting* defines an asset and specifies the asset recognition criteria.

Elements of Cost

STANDARD

5.3 An item of property, plant and equipment must initially be recognised at its cost, which includes costs directly attributable to bringing the item to working condition for its intended use.

COMMENTARY

5.4 The cost of an item of property, plant and equipment is the value of the consideration exchanged or given up to acquire or construct the item, and bring it to working condition for its intended use.

5.5 Where the consideration for the acquisition or construction of an item of property, plant and equipment is deferred, the cost of the item is determined by discounting the amounts payable in the future to their present value at the date of acquisition. The discount rate to be used is the rate at which the acquirer could borrow the amount under similar terms and conditions.

5.6 The cost of an item of property, plant and equipment comprises its purchase price plus any other costs directly attributable to bringing the item to working condition for its intended use. The purchase price includes, for example, the invoice price net of any discounts and recoverable taxes, import duties, broker's or agent's commission, and legal fees. Examples of directly attributable costs are borrowing costs, survey costs, the cost of obtaining resource consents, site preparation costs including land formation costs, installation costs including architectural and engineering fees, freight, and charges for installation, commissioning and testing. Directly attributable costs also include the estimated cost of dismantling and removing the item of property, plant and equipment and restoring the site, to the extent that it is recognised as a provision under the Standard dealing with provisions.

5.7 The cost of an item of property, plant and equipment does not include expenditure incurred in deciding whether the item should be acquired or constructed; for example, feasibility costs or the costs incurred in evaluating a number of proposals for acquisition or construction. Such amounts are pre-acquisition costs and are never capitalised because they are not directly attributable to bringing the item to working condition for its intended use.

5.8 The cost of a self-constructed item of property, plant and equipment is determined using the same principles as for an acquired item of property, plant and equipment. Such cost comprises:

(a) costs that relate directly to the item; for example, direct materials and labour are to be capitalised;

(b) costs attributable to the construction activity in general, but that can be allocated to the specific item; for example, production overheads that directly relate to bringing the item to working condition for its intended use are to be capitalised.

General administrative and selling overheads will normally be excluded from the cost of an item of property, plant and equipment on the grounds that they are not directly attributable to bringing the item to working condition for its intended use. Such costs will be included only when they would have been avoided if there had been no expenditure on the item.

5.9 Unrecoverable operating costs may be incurred because an item of property, plant and equipment is available for use but is incapable of operating at normal levels without a commissioning phase. Such unrecoverable operating costs, to the extent that they are directly attributable to bringing the item to working condition for its intended use, are part of the cost of the item.

5.10 Where an item of property, plant and equipment operates at partial capacity for reasons other than unavoidable commissioning, for example, because demand has not yet built up, any unrecoverable costs are not part of the cost of the item.

5.11 The cost of wasted material, labour or other resources incurred in bringing an item of property, plant and equipment to working condition for its intended use is not included in the cost of the item except to the extent that the cost directly results from unavoidable commissioning. Such expenditure, where it is not to be included in the cost of the item, is to be recognised as an expense when incurred.

5.12 The cost of an item of property, plant and equipment does not include expenditure not directly attributable to the construction or acquisition of the item; for example, costs incurred due to temporary idle capacity, industrial disputes and natural disasters are not capitalised.

5.13 When an entity acquires land for the purpose of constructing a building, and the land is presently occupied by a building intended to be demolished, the demolition costs are part of the cost of the land because they are costs directly attributable to bringing the item to working condition for its intended use. Miscellaneous revenues derived from the demolition are to be deducted in arriving at the cost of the land.

5.14 Except as outlined in paragraph 5.13 of this Standard, the cost of an item of property, plant and equipment will not normally include any demolition or removal costs incurred in the removal of the item of property, plant and equipment being replaced. Such demolition or removal costs are part of the net costs of disposal of the removed item, and are not treated as part of the cost of the replacement item. Section 10 of this Standard deals with the disposal of items of property, plant and equipment.

Allocation of Cost to Individual Items of Property, Plant and Equipment

STANDARD

5.15 When a collection of items of property, plant and equipment is acquired, other than in an acquisition in terms of the Financial Reporting Standard dealing with accounting for acquisitions resulting in combinations of entities or operations, the cost must be allocated to individual items in proportion to their fair values at the time of acquisition.

COMMENTARY

5.16 Judgement is required in determining what constitutes a separate item of property, plant and equipment. It may be appropriate to aggregate individually immaterial items such as moulds, tools, and dies.

5.17 Land and buildings are separable items of property and are usually accounted for separately, even when they are acquired together.

Allocation of Cost to Components of an Item of Property, Plant and Equipment

STANDARD

5.18 When the components of an item of property, plant and equipment have different useful lives or provide benefits to the entity in different patterns, thus requiring different depreciation rates and methods, the cost of the item must be allocated to its components and each component must be accounted for separately.

COMMENTARY

5.19 In certain circumstances it is necessary to allocate the cost of an item of property, plant and equipment to its components and account for each component separately. This is the case when the components have different useful lives or provide benefits to the entity in different patterns, thus requiring different depreciation rates and methods. The level at which components are accounted for separately is therefore the level at which the expected timing of their replacement varies from other components that form part of the same item of property, plant and equipment. For example:

(a) an aircraft and its engines need to be treated as separate items if they have different useful lives;

(b) the land, pavements, formation, kerbs and channels, footpaths, bridges, and lighting need to be treated as separate items within a road system to the extent that they have different useful lives.

5.20 When the components of an item of property, plant and equipment are accounted for separately, decisions in relation to depreciation and subsequent expenditure can be made for each component. If the components are not accounted for separately, it can be difficult to make informed decisions about how an item should be depreciated or whether subsequent expenditure may be capitalised.

5.21 Judgement will be required to decide which components of complex items of property, plant and equipment are accounted for separately. Components will not need to be accounted for separately if materially the same total depreciation expense, carrying amounts and revaluation movements will otherwise result. For entities with asset management plans, it is expected that items of property, plant and equipment will be accounted for at a higher aggregation level (i.e. at a lesser level of detail) than that recorded in the asset management plans.

Cost of Donated or Subsidised Items of Property, Plant and Equipment

STANDARD

5.22 For the purposes of this Standard, the cost of a donated or subsidised item of property, plant and equipment must be its fair value at the date of acquisition, together with any costs directly incurred by the donee in bringing the item to working condition for its intended use. The amount of the donation or subsidy received must be recognised in the statement of financial performance.

COMMENTARY

5.23 In most instances when an item of property, plant and equipment is acquired, the cost of the item provides a measure of its value to the entity at the date of acquisition. When an item of property, plant and equipment is donated, or the acquisition is subsidised, the cost of the item (if any) is not a reliable indication of its value to the entity. This Standard therefore requires the fair value of such items to be determined as a substitute for the cost of purchase, and the amount of the donation or subsidy received to be recognised as revenue in the statement of financial performance.

Borrowing Costs

STANDARD

5.24 Borrowing costs that are directly attributable to the acquisition or construction of an item of property, plant and equipment must be capitalised.

5.25 The amount of borrowing costs capitalised during a period must not exceed the amount of borrowing costs incurred during that period.

COMMENTARY

5.26 Borrowing costs that are directly attributable to the acquisition or construction of an item of property, plant and equipment are those borrowing costs that would have been avoided if the expenditure on the item had not been made.

5.27 When an entity borrows funds specifically for the purpose of obtaining an item of property, plant and equipment, the amount of borrowing costs capitalised is the actual borrowing costs incurred on those borrowings during the period. However, if the borrowed funds are invested temporarily, the amount of the borrowing costs capitalised is limited to the cost of borrowings that funded actual expenditure during the period.

5.28 To the extent that funds are borrowed for general purposes and used to obtain an item of property, plant and equipment, the amount of borrowing costs capitalised is determined by applying a capitalisation rate to the expenditures on that item. Normally the capitalisation rate would be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining other assets.

5.29 Borrowing costs incurred by a member of a group can be capitalised in the group financial report only to the extent of external borrowings by the group.

Commencement of Capitalisation

STANDARD

5.30 Capitalisation must commence:

(a) when activities that are necessary to bring the item to working condition for its intended use are in progress; and

(b) **when expenditures directly attributable to the item are being incurred; and**

(c) **in relation to the capitalisation of borrowing costs, when borrowing costs are being incurred.**

COMMENTARY
5.31 Activities that bring an item of property, plant and equipment to working condition for its intended use encompass more than the physical construction of the item. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits. However, they do not include the work involved in evaluating a number of proposals prior to deciding the nature of the item to be constructed, or similar preliminary activities.

5.32 Activities that bring an item of property, plant and equipment to working condition for its intended use must be in progress before any costs can be capitalised. For example, even if property rates are being incurred, they are to be expensed in the period if no associated development of the item of property, plant and equipment is taking place.

Suspension of Capitalisation

STANDARD
5.33 Capitalisation must be suspended if active development of an item of property, plant and equipment is interrupted.

COMMENTARY
5.34 Costs may still be incurred during an interruption of the activities undertaken to bring an item of property, plant and equipment to working condition for its intended use. Such costs relate to holding a partially completed item of property, plant and equipment and do not qualify for capitalisation to the cost of the item. However, the capitalisation of costs is not normally suspended during a period when substantial technical or administrative work is being carried out. The capitalisation of costs is also not suspended when a temporary delay is a necessary part of the process of bringing the item of property, plant and equipment to working condition for its intended use. For example, the capitalisation of borrowing costs may continue while high water levels delay construction of a bridge if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalisation

STANDARD

5.35 Capitalisation must cease when substantially all the activities necessary to bring an item of property, plant and equipment to working condition for its intended use are complete.

5.36 The construction of an item of property, plant and equipment is sometimes completed in parts, with each part capable of being used while construction continues on other parts. Capitalisation in relation to that usable part must cease when substantially all the activities necessary to prepare that part for its intended use are complete.

COMMENTARY

5.37 A business complex comprising several buildings, each of which can be used individually, is an example of an item of property, plant and equipment where each part is capable of being used while construction continues on other parts. An example of an item of property, plant and equipment that needs to be complete before any part can be used is an industrial plant involving several integrated processes that are carried out in sequence at different parts of the plant within the same site, such as a meat works.

Exchanges of Items of Property, Plant and Equipment

STANDARD

5.38 When an item of property, plant and equipment is exchanged for a similar item of property, plant and equipment, the cost of the acquired item must be the carrying amount of the item given up.

COMMENTARY

5.39 An item of property, plant and equipment may be acquired in exchange for a similar item of property, plant and equipment that has a similar use in the same line of business and which will provide a similar level of future economic benefits. In this case, no revenue or expense is recognised on the transaction because the criteria for the definition and recognition of revenues and expenses, contained in the *Statement of Concepts for General Purpose Financial Reporting,* are not met. Instead, the cost (i.e. the gross carrying amount) of the new item of property, plant and equipment is the carrying amount (i.e. net of accumulated depreciation and impairment losses) of the item given up. Compensation for the impairment or loss of items from third parties is to be accounted for in accordance with paragraph 5.42 of this Standard.

STANDARD

5.40 When an item of property, plant and equipment is acquired in exchange or part exchange for an item of property, plant and equipment that is not similar, the cost of the acquired item must be measured at the fair value of the consideration given, including any costs directly incurred by the entity in bringing the item to working condition for its intended use. Where the fair value of consideration given is not readily ascertainable, reference must be made to the fair value of the item acquired.

COMMENTARY

5.41 An item of property, plant and equipment given up in exchange for an item of property, plant and equipment that is not similar is to be accounted for as having been disposed of. Section 10 of this Standard deals with the disposal of items of property, plant and equipment.

Compensation for the Impairment or Loss of Items of Property, Plant and Equipment

STANDARD

5.42 When compensation is received from third parties in respect of impairments or losses of items of property, plant and equipment:

- **(a) impairments must be accounted for in accordance with section 9 of this Standard;**
- **(b) losses of items must be accounted for in accordance with section 10 of this Standard;**
- **(c) any compensation received or receivable from third parties in respect of the impairment or loss of items must be recognised as revenue in the statement of financial performance;**
- **(d) the cost of items replaced or restored must be determined in accordance with paragraphs 5.22 and 6.1 of this Standard respectively.**

COMMENTARY

5.43 An item of property, plant and equipment may be acquired in a forced or non-voluntary exchange. For example, a new or improved item of property, plant and equipment may be acquired from insurance proceeds when a previously held item of property, plant and equipment has been damaged, lost or destroyed. Impairments or losses of items of property, plant and equipment, the related compensation from third parties, and any subsequent restoration or replacement of the items are separate economic events, and consequently they are to be accounted for separately. Such events are accounted for differently to the accounting for an exchange of similar assets in terms of paragraph 5.38 because no loss ever arises in the latter case. An exchange of similar assets in terms of paragraph 5.38 is a single economic event.

5.44 In circumstances where third party compensation is received in the form of a replacement item and the cost of the replacement item is not readily ascertainable, the replacement item is to be recorded at its fair value at the date of acquisition, together with any costs directly incurred by the entity reporting in bringing the item to working condition for its intended use in accordance with paragraphs 5.22 and 6.1.

6 SUBSEQUENT EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT

STANDARD

6.1 Expenditure relating to an item of property, plant and equipment may be incurred subsequent to the acquisition, development or construction of the item. Such expenditure must be capitalised, either wholly or in part, when:

(a) it is probable that the expenditure increases the economic benefits over the total life of the item beyond those most recently assessed in determining the basis of the item's carrying amount; or

(b) the expenditure was necessarily incurred to enable the future economic benefits embodied in the item to be obtained and the expenditure would have been included in the cost of the item when the item was initially recognised had the expenditure been incurred at that time.

All other subsequent expenditure must be recognised as an expense in the period in which it is incurred.

COMMENTARY

6.2 The following example illustrates what is meant by the phrase in paragraph 6.1(a) of this Standard "increases the economic benefits over the total life of the item beyond those most recently assessed in determining the basis of the item's carrying amount". Suppose an item of plant was initially assessed to have a life of 10,000 hours of operating time and is operated for 3,000 hours over a year, leaving a remaining life of 7,000 hours. The plant then undergoes a major upgrade that adds a further 2,000 hours of operating time to its life. After the upgrade, the plant can be viewed as having a total life of 12,000 hours, which is an improvement on the initially assessed 10,000 hours, and the relevant expenditure is capitalised. During the next year, the plant is operated for 4,000 hours, leaving a remaining life of 5,000 hours. A second upgrade adds another 2,000 hours of operating time to its life. After the second upgrade, the plant can be viewed as having a total life of 14,000 hours, which is an improvement on the most recently assessed 12,000 hours, and the relevant expenditure is capitalised. Other examples include:

(a) upgrading a wastewater and effluent treatment plant to improve the quality of discharge;

(b) adopting a new production process enabling a reduction in previous operating costs and a consequent increase in net future cash flows.

6.3 If it is not probable that expenditure incurred subsequent to acquisition increases the economic benefits over the total life of an item of property, plant and equipment beyond those most recently assessed or such expenditure would not have been capitalised when the item was initially recognised if incurred at that point, the expenditure is to be expensed as incurred. For example:

(a) the cost of servicing plant and equipment is usually expensed since it restores, rather than increases, the most recently assessed economic benefits, and such expenditure is unlikely to be incurred at acquisition;

(b) the cost incurred in repairing potholes that unexpectedly appear in a road is usually expensed because the repairs maintain the useful life of the road, but do not increase the most recently assessed economic benefits, and such expenditure would not be incurred at the point the road is constructed;

(c) the costs of cleaning the environment, removing contamination, and paying fines for breaches of environmental regulations are usually expensed because the expenditure does not increase the most recently assessed economic benefits embodied in the underlying property, plant and equipment, and such expenditure would not be incurred at acquisition.

6.4 Subsequent expenditure relating to an item of property, plant and equipment may be incurred for safety or environmental reasons. Such expenditure may be necessary to realise the future economic benefits embodied in the item of property, plant and equipment. Where this is the case, the expenditure is capitalised if it would have formed part of the initial cost of the item had it been incurred when the item was acquired. For example, assume that subsequent to the acquisition of a chemical production machine new legislation is introduced which makes it illegal for the manufacturer to continue operating the machine unless a special emission control fitting is installed. The subsequent expenditure on the fitting is capitalised because the expenditure is necessary to realise the future economic benefits embodied in the machine and the expenditure would have been included in the initial cost of the machine if the fitting had been installed when the machine was acquired.

6.5 Subsequent expenditure that is capitalised in accordance with paragraph 6.1(b) of this Standard also includes the estimated cost of dismantling and removing an item of property, plant and equipment and restoring the site, where this is recognised during the life of the asset as a provision under the Financial Reporting Standard dealing with provisions. Such cost is necessary to realise the future economic benefits embodied in the item and the expenditure would have been included in the initial cost of the item if a liability for such cost had been incurred when the item was acquired. In this context, expenditure is deemed to have been incurred at the point when a liability for such cost arises.

6.6 As indicated in paragraph 6.3 of this Standard, expenditure in the nature of repairs or maintenance on an item of property, plant and equipment will be expensed as incurred. However, prior to incurring such expenditure, a deterioration in the condition of an item may indicate the need for an impairment writedown in accordance with section 9 of this Standard. If an item is written down as a result of an impairment, and subsequent expenditure restores the item's economic benefits to their pre-impairment level, then the impairment writedown is to be reversed in terms of section 9 of this Standard.

6.7 Where a component of an item of property, plant and equipment is accounted for as a separate item in accordance with paragraph 5.18 of this Standard, it may be more appropriate to account for any subsequent expenditure as a replacement of that component in accordance with sections 5 and 10 of this Standard. The most appropriate accounting treatment will depend on the level at which the item of property, plant and equipment is accounted for. For example:

(a) if the lining is accounted for as a separate component of a furnace, the expenditure incurred in relining the furnace will be capitalised, with the old lining being permanently withdrawn from use;

(b) if the sea walls are accounted for as a separate component of an erosion control system, the expenditure incurred in rebuilding the sea walls will be capitalised, with the old sea walls being permanently withdrawn from use;

(c) if the cost of a major inspection or overhaul of an item, occurring at regular intervals over the item's useful life and made to allow the continued use of the item, has been identified as a separate component of the item and has already been depreciated to reflect the consumption of benefits which are replaced or restored by the subsequent inspection or overhaul, that cost will be capitalised and any remaining carrying value of the previous inspection or overhaul will be recognised as an expense.

In these examples, if the respective items of property, plant and equipment are not accounted for at a component level, the entity will need to assess the impact of the subsequent expenditure against the item of property, plant and equipment as a whole, as illustrated in paragraphs 6.2 and 6.3 of this Standard.

6.8 Certain entities have, in the past, expensed all subsequent expenditure on the basis that asset management plans demonstrated that such expenditure maintained the service potential of certain items of property, plant and equipment for an indefinite period. Asset management plans do not justify the expensing of all subsequent expenditure and the related non-recognition of depreciation. All subsequent expenditure is to be accounted for in accordance with this Standard.

7 REVALUATIONS

STANDARD

7.1 Subsequent to initial recognition, an item of property, plant and equipment may be revalued provided that:

(a) all the items within the class of property, plant and equipment to which the item belongs are revalued to fair value;

(b) subject to paragraph 7.20, revaluations are undertaken on a systematic basis:
- **(i) with sufficient regularity to ensure that no individual item of property, plant and equipment within a class is included at a valuation that is materially different from its fair value; and**
- **(ii) at a minimum, every five years;**

(c) subject to subparagraph (d), the valuation is conducted either:
- **(i) by an independent valuer; or**
- **(ii) where an entity has in its employ a person sufficiently experienced to conduct a valuation, by that person, so long as the basis of valuation has been subject to review by an independent valuer;**

(d) for plant and equipment, where there is an active market or readily available price indices that establish the item's fair value with reasonable reliability, the valuation need not be conducted or reviewed by an independent valuer or experienced employee.

COMMENTARY

7.2 While the annual revaluation of items of property, plant and equipment is not required by this Standard, the adoption of a system involving annual revaluation, especially of land and buildings, is encouraged in order to provide more relevant information to users of an entity's financial report.

7.3 When an item of property, plant and equipment is revalued, the use of fair value is considered to be the most appropriate basis of valuation because it represents the exchange value of the future economic benefits embodied in the asset regardless of the manner in which the entity has chosen to utilise the asset.

7.4 Disposal costs are not deducted in determining the value of an item of property, plant and equipment unless there is an intention to dispose of the item. Items of property, plant and equipment that are intended for sale are dealt with in paragraph 10.10 of this Standard.

7.5 The required frequency of revaluation depends upon movements in the fair value of the items of property, plant and equipment being revalued. When the fair value of a revalued item differs materially from its carrying amount, a further revaluation is necessary. Some items may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items with only insignificant movements in fair value. However, where circumstances arise that are similar to those listed in paragraph 9.4 of this Standard, it will normally be appropriate that the carrying amount of an item be reviewed to assess whether there is any indication that it is likely to differ materially from its fair value. If such an indication exists, the entity should revalue the item. Regular revaluations at intervals of no more than three years are preferable to ensure that the carrying amount of an item remains relevant. However, in every case, at a minimum, an item is to be revalued every five years.

7.6 For the purposes of paragraph 7.1(c), independent valuers are to hold a relevant professional qualification and have experience in the location and category of property, plant and equipment being valued.

7.7 For the purposes of paragraph 7.1(c)(ii), employees sufficiently experienced to conduct valuations are those who possess expert knowledge and experience in the location and category of property, plant and equipment being valued. The basis, methodology and assumptions underpinning valuations conducted by such experienced employees are to be reviewed by independent valuers to ensure the appropriateness of the valuation approach.

7.8 To the extent that the relevant standards and guidance are consistent with principles for determination of fair value set out in section 4 of this Standard, an independent valuation or review by an independent valuer is to be carried out in accordance with standards and guidance comparable to the valuation pronouncements issued, or officially endorsed, by the New Zealand Property Institute.

7.9 For the purposes of paragraph 7.1(d) of this Standard, a valuation may be undertaken without the need for an independent valuer or experienced employee only where there is sufficient objective market information available which enables two or more non-experts to determine materially the same fair values of the particular item of property, plant and equipment. Paragraph 7.1(d) is not applicable where depreciated replacement cost is the most appropriate basis for determination of the fair value of an item of property, plant and equipment.

7.10 A valuation carried out for purposes other than financial reporting, for example a rating valuation, is not to be used as the basis for recording a revaluation unless the basis of valuation has been confirmed as appropriate, in accordance with the requirements of this Standard, by an independent valuer.

Recognition of Revaluation Increments and Decrements

STANDARD

7.11 When an item of property, plant and equipment is revalued, the related accumulated depreciation charges as at the date of revaluation must be credited to the gross carrying amount of the item. The gross carrying amount must then be increased or decreased by the amount of the revaluation increment or decrement.

COMMENTARY

7.12 Although the effect of paragraph 7.11 is to require accumulated depreciation to be reset at nil at the time an asset is revalued, for the purposes of the disclosure requirement in paragraph 11.3(a) an entity may also disclose separately the gross amounts and related accumulated depreciation of the assets composing the class of revalued assets.

STANDARD

7.13 Subject to the requirements of paragraphs 7.14 and 7.15 of this Standard, when an item of property, plant and equipment is revalued, the resultant revaluation increment or decrement must be recognised in the statement of movements in equity.

7.14 If the revaluation of an item of property, plant and equipment results in a revaluation deficit for the class of property, plant and equipment to which that item belongs, the revaluation deficit must be recognised in the statement of financial performance.

7.15 To the extent that the revaluation of an item of property, plant and equipment reverses a previous revaluation deficit, for the class of property, plant and equipment to which the item belongs, that was recognised in the statement of financial performance, such revaluation increment must be recognised in the statement of financial performance.

COMMENTARY

7.16 An item of property, plant and equipment may be revalued downwards, and the amount of the revaluation decrement may be greater than the existing revaluation surplus for the class of property, plant and equipment to which that item relates. In this case, the resulting revaluation deficit is to be recognised in the statement of financial performance.

7.17 An item of property, plant and equipment may be revalued upwards, and the amount of the revaluation increment may reverse (or partially reverse) a previous revaluation deficit in respect of the class of property, plant and equipment to which that item relates, that was recognised in the statement of financial performance. In this case, the revaluation increment is to be recognised in the statement of financial performance to the extent that it reverses the revaluation deficit that was recognised in the statement of financial performance.

Change in Measurement Base

STANDARD

7.18 A change in the measurement base of a class of property, plant and equipment must be accounted for as a change in accounting policy.

COMMENTARY

7.19 An entity may change the measurement base of a class of property, plant and equipment from the historical cost to the modified historical cost system of accounting. Such a change is a change in accounting policy.

STANDARD

7.20 Where an entity revalues a class of property, plant and equipment, it is permitted to change the measurement base of that class by ceasing to revalue if:

(a) the change will result in information about the class of item that is more relevant or reliable;

(b) continual revaluations for that class of item cannot be justified for materiality or cost-benefit reasons; or

(c) the entity has been subject to an acquisition resulting in a combination of entities and has revalued its property, plant and equipment solely to align the carrying values of such assets with the cost of acquisition.

If the entity ceases to revalue a class of property, plant and equipment, it is not required to restate that class at carrying amounts determined as if the modified historical cost system of accounting had never been adopted.

COMMENTARY

7.20A An example of circumstances where an entity might, for cost-benefit reasons, cease to revalue a class of property, plant and equipment is where the entity has become a wholly-owned subsidiary of another entity that recognises that class of property, plant and equipment on the cost basis.

7.21 An entity that has been subject to an acquisition resulting in a combination of entities may revalue its property, plant and equipment solely to align the carrying values of such assets with the cost of acquisition. This is commonly referred to as "push down accounting". Such circumstance does not require the entity to continue to revalue in accordance with paragraph 7.1(b).

7.22 If an entity ceases to revalue a class of property, plant and equipment in accordance with paragraph 7.20 of this Standard, it is preferable that the most recent valuation forms the basis upon which the class of item will henceforth be accounted for. In such a situation, the class of item will henceforth be accounted for according to historical cost principles. However, an entity may instead restate the carrying amount of each asset to those amounts that would have been reported had the class of items always been accounted for at historical cost. In such case, the adjustment to the asset value should be treated as a revaluation in accordance with paragraph 7.11 and paragraphs 7.13 to 7.15 of this Standard.

8 DEPRECIATION

STANDARD

8.1 The depreciable amount of an item of property, plant and equipment must be charged over the item's useful life. The depreciation charge for each period must be recognised as an expense in the statement of financial performance unless it is included in the cost of another asset.

COMMENTARY

8.2 As the economic benefits embodied in an item of property, plant and equipment are consumed by the entity, the carrying amount of the item is reduced to reflect this consumption.

8.3 In this Standard, depreciation is regarded as a measure of the cost or value of the economic benefits embodied in an item of property, plant and equipment consumed. Depreciation is not regarded as a measure of the decline in value of an item of property, plant and equipment.

8.4 The depreciation charge for a period is usually recognised as an expense. However, in some circumstances, the economic benefits embodied in an item of property, plant and equipment are absorbed by the entity in producing other assets. In this case, the depreciation charge is a component cost of the other asset and is included in the carrying amount of the other asset. For example:

(a) the depreciation charge for manufacturing plant and equipment is included in the cost of conversion of inventories — refer FRS-4: *Accounting for Inventories*;

(b) the depreciation charge for an item of property, plant and equipment used in development activities may be included in development costs that are recognised as an asset — refer FRS-13: *Accounting for Research and Development Activities*.

8.5 The depreciation charge commences from the date that consumption of the economic benefits embodied in an item of property, plant and equipment commences. Where an item of property, plant and equipment is a complex structure made up of interdependent sub-structures that require installation in successive stages, consumption of the item's economic benefits commences only after installation has been completed to a stage where service or saleable product can be obtained.

8.6 Although an item of property, plant and equipment may remain idle, the economic benefits embodied in the item may still be consumed through the passing of time or obsolescence. If the economic benefits embodied in the item are being consumed, it is necessary to reflect that consumption in the depreciation charge.

8.7 A variety of methods can be used to depreciate an item of property, plant and equipment over its useful life. These methods include the straight-line method, the diminishing balance method and the sum-of-the-digits method. The chosen method should reflect the expected pattern of consumption of economic benefits. The chosen method is to be consistently applied from period to period unless there is a change in the expected pattern of consumption of economic benefits from that item of property, plant and equipment. The method referred to as the inverse- or inverted-sum-of-the-digits is not normally considered appropriate because it does not reflect the usual pattern of consumption of economic benefits embodied in an item of property, plant and equipment.

8.8 In determining how to allocate the cost of the consumption of economic benefits over the useful life of an item of property, plant and equipment, an appropriate basis should be used. For example, the consumption of economic benefits may be determined based on the number of units produced or by the mileage achieved.

8.9 Major spare parts held for a specific item of property, plant and equipment, and which would become redundant if that item was no longer in use, are to be depreciated on the same basis as the item for which they are held. Generally, the useful life and the appropriate method of charging depreciation for the base stock of spare parts that cannot be attributed to specific items of property, plant and equipment are assessed independently of other items of property, plant and equipment.

8.10 Certain entities that qualify for differential reporting are permitted to adopt the rates of depreciation applicable for income tax purposes, as described in paragraph 2.2(a) of this Standard. Other entities may also adopt rates of depreciation applicable for income tax purposes where such adoption is not of a material consequence.

8.11 The use of an asset management plan by an entity to manage items of property, plant and equipment does not negate the requirement to charge depreciation to reflect the consumption of economic benefits in accordance with paragraph 8.1 of this Standard. An appropriate depreciation charge will be determined only if the different components of an item of property, plant and equipment are accounted for separately as required by paragraph 5.18 of this Standard.

8.12 An approach that has previously been adopted by some entities in accounting for infrastructure assets is commonly referred to as the long-run-average-renewals-approach (LRARA). The expense for the period that results from the application of LRARA is not an appropriate estimate of depreciation for the purposes of this Standard. The application of LRARA does not comply with this Standard because the expense for the period is determined based on projected expenditure for a limited future period rather than based on the consumption of the service potential embodied in the carrying amount of the asset.

Depreciation Charges for a Revalued Item of Property, Plant and Equipment

STANDARD

8.13 When an item of property, plant and equipment is revalued, the depreciation charge must be calculated on the revalued amount from the date of that revaluation.

COMMENTARY

8.14 Because this Standard regards depreciation as a measure of the economic benefits consumed, depreciation is to be charged even when an item of property, plant and equipment is revalued.

8.15 In the reporting period in which the revaluation takes place:

(a) for the period prior to the date of revaluation, the depreciation charge is to be calculated on the pre-revaluation depreciable amount;

(b) for the period after the date of revaluation, the depreciation charge is to be calculated on the post-revaluation depreciable amount.

Review of Basis for Depreciation Charge

STANDARD

8.16 The useful life of an item of property, plant and equipment must be assessed annually to determine whether there is any indication that it is inappropriate. If any such indication exists, the depreciation charge for the current period and future periods must be reviewed and adjusted if necessary.

COMMENTARY

8.17 During the life of an item of property, plant and equipment it may become apparent that the estimate of the item's useful life is inappropriate. For example, technological changes or changes in the market for the products may change the useful life of the item. Also, uncertainty about the estimate of the useful lives of long-lived assets may itself be an indication that the useful lives should be regularly reviewed. In such cases the useful life, and therefore the depreciation rate, is adjusted for the current and future periods; the depreciation charge in respect of prior periods is not recalculated and charged in the current year.

STANDARD

8.18 When an item of property, plant and equipment is revalued, a revised estimate of the item's residual value must be made. If the item is not revalued, the residual value must not be increased for changes in prices.

COMMENTARY

8.18A The estimate of residual value is based on the net amount to be recovered for similar items which have reached the end of their useful lives and which have operated under similar conditions. In general, when an item of property, plant and equipment is not revalued, the estimate of residual value is expressed in terms of the amount expected as at the date of acquisition and not some future value which would take into account the effect of inflation on prices. Residual values may still be decreased or increased for reasons other than changes in prices. For example, the residual value may need to be reduced where it becomes evident that the carrying amount of an item is above its recoverable amount. Also, the residual value may need to be increased where there is a reduction in the estimated useful life of an item to an entity because the entity decides it will dispose of the item earlier than originally planned.

STANDARD

8.19 The depreciation method for an item of property, plant and equipment must be reviewed annually. If there has been a change in the expected pattern of consumption of economic benefits embodied in those items, the method of charging depreciation must be changed to reflect the changed pattern. When a change in the depreciation method is necessary, the depreciation charge for the current and future periods must be adjusted.

COMMENTARY

8.20 When making a change in estimate in accordance with the requirements of paragraphs 8.16, 8.18 and 8.19 of this Standard, no adjustments are to be made in respect of prior periods.

9 IMPAIRMENT

Identification of Potentially Impaired Non-revalued Items of Property, Plant and Equipment, and Measurement of Impairment Losses

STANDARD

9.1 The requirements in section 9 of this Standard apply to all items of property, plant and equipment except those that are revalued and meet both conditions (i) and (ii) of paragraph 7.1(b) and other relevant requirements of this Standard concerning revaluation.

COMMENTARY

9.2 Impairments of revalued items of property, plant and equipment are dealt with through the requirement in paragraph 7.1(b) of this Standard that revaluations be made with sufficient regularity to ensure that no item of property, plant and equipment is included at a valuation that is materially different from its fair value. Accordingly, the requirements in section 9 of this Standard do not apply to revalued items of property, plant and equipment unless such items have ceased to be revalued in accordance with paragraph 7.20 of this Standard. However, the guidance in section 9 of this Standard will often be helpful in assessing whether the fair value has fallen materially below a revalued item's carrying value.

STANDARD

9.3 Subject to paragraph 9.1, where the future economic benefits embodied in an item of property, plant and equipment are directly related to its ability to generate net cash inflows, the carrying amount of the item must be reviewed at each reporting date to assess whether there is any indication that the item may be impaired. The review of the carrying amount must be made after the assessment of useful life under paragraph 8.16. If there is any indication that the carrying amount of the item exceeds the item's recoverable amount, the entity must estimate the item's recoverable amount.

9.4 Subject to paragraph 9.1, the following indications, as a minimum, must be considered in assessing whether there is any indication that an item of property, plant and equipment may be impaired:

External sources of information

(a) during the period, the item's fair value has declined significantly more than would be expected as a result of the passage of time or normal use;

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an item is dedicated;

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an item's value in use and decrease the item's recoverable amount materially;

(d) the carrying amount of the net assets of the entity is more than its market capitalisation;

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an item;

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an item is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an item belongs or to dispose of an item before the previously expected date; and

(g) evidence is available from internal reporting that indicates that the economic performance of an item is, or will be, worse than expected.

COMMENTARY

9.5 The list of indications of impairment in paragraph 9.4 is not exhaustive. Other indications that an item of property, plant and equipment may be impaired may exist and these would also require the entity to determine the item's recoverable amount.

9.6 Evidence from internal reporting that indicates that an item of property, plant and equipment may be impaired includes the existence of:

(a) cash flows for acquiring the item, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating surplus or deficit flowing from the item that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating surplus, or a significant increase in budgeted deficit, flowing from the item; or

(d) operating deficits or net cash outflows for the item, when current period figures are aggregated with budgeted figures for the future.

9.7 If no indication of a potential impairment loss is present, this Standard does not require an entity to make a formal estimate of recoverable amount.

9.8 In assessing the recoverable amount of an item of property, plant and equipment, the level of future economic benefits embodied in the item at the reporting date is to be considered. For example, the future economic benefits embodied in an item of property, plant and equipment may be reduced when safety or environmental standards are imposed, or when the item is damaged.

9.9 Recoverable amount is determined for an individual item of property, plant and equipment, unless the item does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the item belongs, unless either:

(a) the item's net market value is higher than its carrying amount; or

(b) the item's value in use can be estimated to be close to its net market value and net market value can be determined.

Recognition of Impairment Losses

STANDARD

9.10 Subject to paragraph 9.1, if, and only if, the recoverable amount of an item of property, plant and equipment is less than its carrying amount, the carrying amount of the item must be written down to its recoverable amount.

9.11 The writedown to recoverable amount of an item of property, plant and equipment must be recognised in the statement of financial performance.

COMMENTARY

9.12 If an item of property, plant and equipment is written down to its recoverable amount, the writedown is not considered to be a revaluation and the class of property, plant and equipment to which that item belongs is not required to be revalued.

STANDARD

9.13 An assessment must be made at each balance sheet date of whether there is any indication that an impairment loss recognised for an item of property, plant and equipment in prior years may no longer exist or may have decreased. If any such indication exists, the recoverable amount of that item must be estimated.

9.14 The following indications, as a minimum, must be considered in assessing whether there is any indication that an impairment loss recognised for an item of property, plant and equipment in prior years may no longer exist or may have decreased:

External sources of information

(a) the item's fair value has increased significantly during the period;

(b) significant changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates, or in the market to which the item is dedicated;

(c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the item's value in use and increase the item's recoverable amount materially;

Internal sources of information

(d) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the item is used or is expected to be used. These changes include capital expenditure that has been incurred during the period to improve or enhance an item in excess of its most recently assessed standard of performance or a commitment to discontinue or restructure the operation to which the item belongs; and

(e) evidence is available from internal reporting that indicates that the economic performance of the item is, or will be, better than expected.

9.15 The carrying amount of an item of property, plant and equipment that has previously been written down to recoverable amount in accordance with paragraph 9.10 must be increased to its current recoverable amount if, and only if, there has been a change in the estimates used to determine the recoverable amount. The increased carrying amount of the item must not exceed the carrying amount that would have been determined if the writedown to recoverable amount had not occurred.

9.16 The reversal of a writedown to recoverable amount of an item of property, plant and equipment must be recognised in the statement of financial performance.

COMMENTARY

9.17 A writedown to recoverable amount is to be reversed only when the estimates used in determining the writedown have changed. For example, if an item of property, plant and equipment was written down because the item was damaged and could not operate at full capacity, the writedown is to be reversed once the item is repaired and its operating capacity is restored.

9.18 When a writedown to recoverable amount is to be reversed, the reversal is limited to the amount that brings the carrying amount to what it would have been if the writedown had not occurred. Therefore the reversal will be reduced by amounts such as the additional depreciation that would have been recognised as an expense based on the carrying amount prior to the writedown.

Future Economic Benefits Not Directly Related to Ability to Generate Net Cash Inflows

STANDARD

9.19 Subject to paragraph 9.1, the carrying amount of an item of property, plant and equipment whose future economic benefits are not directly related to its ability to generate net cash inflows, must not exceed the following at the reporting date:

(a) net market value; or

(b) where net market value cannot be determined because such items are rarely if ever sold on the open market except as part of the sale of a business in occupation, depreciated replacement cost.

COMMENTARY

9.20 An item of property, plant and equipment may generate future economic benefits other than cash inflows. If such an item forms part of an identifiable cash generating unit in which the economic benefits are directly related to the unit's ability to generate cash inflows, then the item is to be accounted for under paragraphs 9.3 and 9.10 of this Standard.

STANDARD

9.21 Any writedown required in accordance with paragraph 9.19 of this Standard must be recognised in accordance with the requirement of paragraph 9.11 of this Standard.

9.22 The amount of a writedown made in accordance with paragraph 9.19 of this Standard must be reversed if there has been a change in the estimates used to determine the amount of the writedown. The increased carrying amount of the item must not exceed the carrying amount that would have been determined if the writedown had not occurred.

9.23 Any reversal of a writedown made in accordance with paragraph 9.22 of this Standard must be recognised in accordance with the requirement of paragraph 9.16 of this Standard.

10 DISPOSAL OR PERMANENT WITHDRAWAL OF PROPERTY, PLANT AND EQUIPMENT

STANDARD

10.1 On disposal or permanent withdrawal of an item of property, plant and equipment:

(a) the difference between net disposal proceeds (if any) and the carrying amount must be recognised in the statement of financial performance; and

(b) the revaluation surplus must be reduced or increased, as relevant, by any amounts applicable to that item.

COMMENTARY

10.2 Where an item of property, plant and equipment is disposed of, but receipt of the sale proceeds is deferred by agreement, the consideration received for the item is determined by discounting the amounts receivable in the future to their present value at the date of disposal. The discount rate to be used is the rate at which the vendor could invest the amount under similar terms and conditions.

10.3 An item of property, plant and equipment is permanently withdrawn when no further future economic benefits are expected from its use or disposal; for example, when it is withdrawn from use and not intended to be sold.

10.4 An item of property, plant and equipment that is withdrawn from use and held for disposal may be classified as a current asset or a non-current asset. Where the item is readily realisable and intended to be held for not more than one year, classification as a current asset is appropriate. For an item intended for sale to be classified as a current asset, there is to be evidence of intent to sell including authorisation by the governing body, listing for sale or similar evidence. Where these criteria are not met, the item intended for sale is to be classified as a non-current asset.

10.5 The revaluation surplus referred to in paragraph 10.1(b) of this Standard is defined in paragraph 4.46 of this Standard. It represents the net accumulated revaluation increments and decrements on a class of asset basis. It is determined to enable revaluation decrements (and any corresponding reversals) in respect of an item of property, plant and equipment to be accounted for in accordance with the requirements of sections 7 and 9 of this Standard and to enable the disclosure required by paragraph 11.4(a) of this Standard to be met. When an item of property, plant and equipment is disposed of or permanently withdrawn, the net amount applicable to that asset that has been previously included in the net accumulated revaluation increments and decrements for that asset class is then excluded from that time.

10.6 In some cases, entities may choose to disclose revaluation reserves as separate components of equity. Where the reserves are disclosed separately for each class of assets, the amounts of such reserves are the same as the revaluation surplus referred to in paragraph 10.1(b) of this Standard. If, instead, a combined revaluation reserve for all asset classes is disclosed, the amount of the combined reserve will be the aggregate of the revaluation surpluses for all asset classes. In cases where revaluation reserves have been disclosed as separate components of equity, the portion of a revaluation reserve applicable to any asset that has been disposed of or permanently withdrawn is taken out of the revaluation reserve but remains in other equity.

STANDARD

10.7 If the disposal or permanent withdrawal of an item of property, plant and equipment results in a revaluation deficit for the class of property, plant and equipment to which that item belongs, the revaluation deficit must be recognised in the statement of financial performance.

10.8 When an item of property, plant and equipment is exchanged for an equity interest in the same or a similar item of property, plant and equipment and such interest provides access to the same level of service potential or future economic benefits, a gain or loss on disposal of the item must not be recognised.

COMMENTARY

10.9 An item of property, plant and equipment may be acquired in exchange for an equity interest in a similar item of property, plant and equipment that has a similar use in the same line of business and which has a similar fair value. Where such interest provides access to the same level of service potential or future economic benefits, no revenue or expense is recognised on the transaction because the criteria for recognition of revenues and expenses, contained in the *Statement of Concepts for General Purpose Financial Reporting* are not met.

STANDARD

10.10 An item of property, plant and equipment withdrawn from use and intended for sale must be recorded at the lower of:

(a) carrying amount at the date the item is withdrawn from use; and

(b) net market value.

11 DISCLOSURE REQUIREMENTS

STANDARD

11.1 The financial report must disclose, in respect of each class of property, plant and equipment:

(a) the measurement bases used for determining the gross carrying amount; or when more than one basis has been used, the gross carrying amount relating to each basis;

(b) the depreciation methods used; and

(c) the useful lives or the depreciation rates used.

COMMENTARY

11.2 It is possible for items within a class of property, plant and equipment to be carried at amounts determined using different measurement bases. One example is where only some items within a class of property, plant and equipment have a gross carrying amount determined in accordance with the transitional provisions of paragraph 12.2 of this Standard. Another example is where the carrying amounts of some items within a class of property, plant and equipment are revalued amounts, but other items are capitalised at cost before the next revaluation occurs in terms of paragraph 7.1(b) of this Standard. In these cases, the gross carrying amount attributable to each measurement base within the class is to be disclosed.

STANDARD

11.3 The financial report must disclose, in respect of each class of property, plant and equipment, and in total for all classes:

(a) the gross carrying amount, the accumulated depreciation charges (including accumulated impairment losses), and the carrying amount;

(b) the carrying amount of property, plant and equipment not in current use with separate disclosure of:

- **(i) items that have been withdrawn from use and are not in regular use; and**
- **(ii) items under construction;**

(c) the total depreciation charge for the period;

(d) the total of impairment losses recognised during the period;

(e) the total of impairment losses reversed during the period;

*** (f) the amount of borrowing costs capitalised during the period.**

11.4 When a class of property, plant and equipment is stated at revalued amounts the following must be disclosed in respect of that class:

(a) the revaluation surplus;

*** (b) the intervals at which valuations take place;**

(c) the dates and amounts of valuations supporting the recognised valuations;

(d) the name and qualifications of the valuer(s);

(e) the bases of the valuations;

(f) any significant assumptions or limiting conditions upon which the valuations are based;

*** (g) where the cyclical basis of valuation has been adopted, that fact and an explanation of the basis used.**

COMMENTARY

11.5 Examples of significant assumptions or limiting conditions upon which a valuation is based may include the following in the case of depreciated replacement cost:

(a) where the valuation relates to property, the basis upon which the fair value of the land has been determined;

(b) the extent of optimisation taken into account.

STANDARD

11.6 When a class of property, plant and equipment is no longer revalued because of a change in policy in accordance with paragraph 7.20 of this Standard, then the following must be disclosed in the period of the change in policy in respect of that class:

(a) the fact that the class of items is no longer accounted for under the modified historical cost system of accounting; and

(b) the basis upon which the class of item is now accounted for.

COMMENTARY

11.7 When a class of property, plant and equipment that was once revalued is no longer revalued, the class of item will be accounted for either:

(a) on the basis of the most recent valuation of that class of property, plant and equipment but by applying historical cost principles to the revalued amounts; or

(b) on the basis of the historical cost of the items within the class (i.e. as if the modified historical cost system had never been adopted).

STANDARD

11.8 When items of property, plant and equipment are revalued, the following must be disclosed:

(a) as a separate component of total recognised revenues and expenses, the sum of all revaluation increments and decrements recognised in the statement of movements in equity during the period;

(b) the sum of all revaluation increments and decrements recognised in the statement of financial performance during the period.

*** 11.9 Where the depreciation charges for any reporting period have changed because of:**

(a) the reassessment of the useful lives or residual values of items of property, plant and equipment;

(b) changes in depreciable amounts arising from the revaluation of items of property, plant and equipment; or

(c) changes in the methods used to measure depreciation;

that fact, as well as the financial effect of the change, must be disclosed.

11.10 Where the entity changes the measurement base for any class of property, plant and equipment, the following must be disclosed:

(a) the change in accounting policy in accordance with FRS-1: *Disclosure of Accounting Policies*;

(b) whether the measurement base has been changed previously and, if so, when.

11.11 Where the entity recognises a revenue or expense adjustment in accordance with paragraph 12.8 of this Standard, the adjustment must be separately disclosed and its nature explained.

12 TRANSITIONAL PROVISIONS

STANDARD

12.1 Where an entity has recognised infrastructure assets at 31 March 2001 and is using methods of accounting that do not comply with sections 6, 7, 8, or 9 of this Standard to account for the infrastructure assets at 31 March 2001, the entity is exempt from applying the requirements of the relevant section(s) in accounting for the infrastructure assets until periods ending on or after 31 March 2004.

12.2 Where at 1 October 1991 (the date from which the predecessor to this Standard, SSAP-28: *Accounting for Fixed Assets*, applied) an entity carried items of property, plant and equipment at a valuation, and it did not thereafter revalue these items in accordance with SSAP-28, the entity is permitted to account for these items using their gross carrying amounts as at 1 October 1991.

COMMENTARY

12.3 The transitional provision in paragraph 12.2 relates only to the measurement of the gross carrying amounts for the purposes of this Standard. Where applicable, the items must still be accounted for at the component level in accordance with the requirements of this Standard.

STANDARD

12.4 Where an entity, at or before 31 March 2001:

(a) has recognised property, plant and equipment at revalued amounts (in accordance with SSAP-28); and

(b) intends to continue to revalue a class of property, plant and equipment, in accordance with section 7 of this Standard,

the entity is exempt from applying the requirements of paragraph 7.1(a) and (b) of this Standard in accounting for that class of property, plant and equipment until periods ending on or after 31 March 2004 providing that the entity applies the requirements in paragraph 12.5.

12.5 An entity which qualifies for the transitional exemption in paragraph 12.4, may maintain its existing cycle for the revaluation of a class of property, plant and equipment provided that :

(a) all revaluations on or after 1 April 2001 are undertaken in accordance with paragraph 7.1(a) and (b) of this Standard; and

(b) all assets within that class are revalued in accordance with section 7 of this Standard by the first reporting period ending on or after 31 March 2004.

COMMENTARY

12.6 The effect of paragraph 12.5 is that entities that have been revaluing property, plant and equipment under SSAP-28 are allowed to maintain their SSAP-28 revaluation cycle during the changeover to FRS-3. However, all revaluations of assets within a relevant class which are undertaken on or after 1 April 2001 are to be undertaken in accordance with the Standard, and all assets within a class are required to be revalued in accordance with the Standard by the first reporting period ending on or after 31 March 2004.

12.7 Where a cyclical basis of revaluation is applied, compliance with section 11 of this Standard will ensure that, for each class of property, plant and equipment, the following will be disclosed:

(a) the gross carrying amount relating to each measurement base used. For example, historical cost, revalued amounts determined prior to revaluation in accordance with this Standard (i.e in accordance with SSAP-28) and the revalued amounts determined as part of the cyclical valuation in accordance with this Standard; and

(b) the bases of the valuations.

STANDARD

12.8 Where an entity changes an accounting policy in order to comply with the principles of this Standard for the first time, any revenue or expense that arises, other than an impairment loss, must be recognised in the statement of movements in equity in the period in which the change is implemented.

COMMENTARY

12.9 The requirement in paragraph 12.8 applies to changes in policies in respect of both assets subject to the requirements of this Standard and assets not subject to the requirements of this Standard but which are accounted for in accordance with the principles of this Standard. A change from net current value on an existing use basis (under SSAP-28) to fair value (under FRS-3) constitutes an accounting policy change. The requirement in paragraph 12.8 does not cover the recognition of impairment losses and recoveries. These are to be accounted for in accordance with section 9 of this Standard.

12.10 Where entities revalue property, plant and equipment cyclically in accordance with paragraph 12.5, the effect of paragraph 12.8 is that any revenue or expense that arises on revaluation, is recognised in the statement of movements in equity in the period in which the revenue or expense arises. These adjustments are only permitted during the period of the cyclical valuation until periods ending on or after 31 March 2004.

STANDARD

12.11 Where an entity, at or before 31 March 2001:

(a) has recognised infrastructure assets at revalued amounts and is, accordingly, subject to section 7 of this Standard; and

(b) has not, in accounting for the revaluation changes of such infrastructure assets, maintained a revaluation reserve for each component that is, in accordance with this Standard, required to be separately accounted for,

the entity is exempt from applying the requirements of paragraph 10.1 (b) of this Standard until periods ending on or after 31 March 2007.

12.12 An entity is not required to comply with the requirement to capitalise borrowing costs (as specified in paragraphs 5.24 to 5.37 of this Standard) until FRS-3 is superseded by the New Zealand equivalent of IAS 16: *Property, Plant and Equipment* and IAS 23: *Borrowing Costs.* The treatment of borrowing costs adopted by such an entity must however be applied consistently to all items of property, plant and equipment.

COMMENTARY

12.13 Where an entity, in terms of paragraph 12.12, expenses borrowing costs and, on revaluation, uses depreciated replacement cost as a basis for determining fair value, the depreciated replacement cost would not include a borrowing cost component as explained in paragraph 4.21.

APPENDIX

Comparison of FRS-3 with International and Australian Accounting Standards

This comparison appendix was prepared as at 1 February 2000 and deals only with significant differences between the standards. The comparison is produced for information purposes only and does not form part of the standards in FRS-3.

International Accounting Standards are promulgated by both the International Accounting Standards Committee (IASC) and the Public Sector Committee of the International Federation of Accountants (IFAC PSC). The International standards referred to in this Appendix cover only those promulgated by the IASC because the IFAC PSC has not yet promulgated standards on this topic.

The International and Australian accounting standards comparable with FRS-3 are:

IASC

- IAS 16 (revised 1998): *Property, Plant and Equipment*
- IAS 23 (1993): *Borrowing Costs*
- IAS 36: *Impairment of Assets*

Australia

- AASB 1010 (1999): *Recoverable Amount of Non-Current Assets*
- AAS 10 (1999): *Recoverable Amount of Non-Current Assets*
- AASB 1015 (1999): *Acquisition of Assets*
- AAS 21 (1999): *Acquisition of Assets*
- AASB 1021 (revised 1997): *Depreciation*
- AAS 4 (revised 1997): *Depreciation*
- AASB 1036 (1997): *Borrowing Costs*
- AAS 34 (1997): *Borrowing Costs*
- AAS 27 (revised 1996): *Financial Reporting by Local Governments*
- AAS 29 (revised 1996): *Financial Reporting by Government Departments*
- AAS 31 (1996): *Financial Reporting by Governments*

- AASB 1041 (1999): *Revaluation of Non-Current Assets*
- AAS 38: *Revaluation of Non-Current Assets*.

The following summarises the significant differences between the above pronouncements, and FRS-3.

(Note that this appendix is written in a different style to equivalent appendices in other financial reporting standards to the extent that the discussion is not premised on a comparison of particular standards. This is because equivalent requirements vary across a range of standards within each jurisdiction. Accordingly the appendix is designed to compare requirements in the jurisdictions rather than the requirements in particular standards.)

Initial Recording of Property, Plant and Equipment

IAS 16, in conjunction with IAS 20: *Accounting for Government Grants and Disclosure of Government Assistance*, allows government grants to be deducted in determining the cost of an item of property, plant and equipment. FRS-3 requires a donated or subsidised item of property, plant and equipment to be recorded at its fair value at the date of acquisition together with any costs incurred by the donee in bringing the item to working condition for its intended use. AAS 27, AAS 29 and AAS 31 are similar to FRS-3, as is Australian Urgent Issues Group Abstract 11: *Accounting for contributions of, or contributions for the acquisition of, non-current assets.*

The benchmark treatment in IAS 23 is to expense borrowing costs; capitalisation of borrowing costs is an allowed alternative treatment. FRS-3 requires borrowing costs directly attributable to the acquisition or construction of an item of property, plant and equipment to be capitalised, as does AASB 1036/AAS 34.

Subsequent Expenditure on Property, Plant and Equipment

FRS-3 requires subsequent expenditure to be capitalised where either:

- it increases the economic benefits over the total life of the related item of property, plant and equipment beyond those most recently assessed in determining the basis of the item's carrying amount; or

- it is necessarily incurred to realise the future economic benefits embodied in the item and it would have been included in the initial cost of the item had it been incurred when the item was acquired.

FRS-3

IAS 16 is consistent with FRS-3 with regard to expenditure which increases the item's economic benefits over its total life; however, IAS 16 is silent with regard to necessarily incurred subsequent expenditure. There is no Australian standard that specifically deals with this issue.

Revaluations

FRS-3 requires revaluation increments and decrements within a class of property, plant and equipment to be offset, with only the net revaluation increment or decrement for the class (referred to in FRS-3 as, respectively, the revaluation surplus or revaluation deficit) to be accounted for. IAS 16 requires revaluation increments and decrements to be accounted for on the basis of individual items of property, plant and equipment. AASB 1041/AAS 38 is similar to FRS-3.

FRS-3, IAS 16 and AASB 1041/AAS 38 require revaluations to be carried out with sufficient regularity to ensure that the carrying amount of an item of property, plant and equipment is not materially different from its fair value. However, FRS-3 has an additional requirement which does not allow an item of property, plant and equipment to be included at a valuation that was determined more than five years previously.

FRS-3 permits an entity that has revalued a class of property, plant and equipment to stop revaluing under certain conditions. These include circumstances where materiality or cost-benefit reasons justify the change and where one-off revaluations have occurred as a result of the entity being part of a business combination. The ability to stop revaluing exists under IASC standards (IAS 8: *Net Profit for the Period; Fundamental Errors and Changes in Accounting Policies*) but does not exist under the Australian standards, except at the date of first application of AASB 1041/AAS 38.

Impairment

IAS 36 does not provide any guidance in relation to items of property, plant and equipment whose future economic benefits are not directly related to their ability to generate net cash inflows. AASB 1010/AAS 10 does not require the recoverable amount test to be applied to non-current assets of not-for-profit entities where the service potential of those assets is not primarily dependent on their ability to generate net cash inflows, or to non-current assets which, pursuant to legislation, ministerial directive or other government authority, provide goods or services at no charge, or at less than full cost recovery. FRS-3 provides that items of property, plant and equipment whose future economic benefits are not directly related to their ability to generate net cash inflows, should not be recorded at an amount greater than:

- net market value; or
- where net market value cannot be determined, depreciated replacement cost.

Disclosure

Where an entity revalues a class of property, plant and equipment, IAS 16 requires disclosure of what the carrying amount of that class would have been if no revaluation had taken place. FRS-3 does not require this disclosure, and nor does AASB 1041/AAS 38.

History

FRS-3: Accounting for Property, Plant and Equipment (revised February 2002 and effective for periods ending on or after 31 March 2002) amended as follows: addition of paragraphs 12.12 and 12.13.

FRS-3: Accounting for Property, Plant and Equipment (revised November 2001 and effective for periods ending on or after 31 March 2002) amended as follows: the addition of paragraphs 4.20A, 4.26A, 7.20A, 8.18A, 12.4, 12.5, 12.6; 12.7, and 12.10; changed wording in paragraphs 8.18, 12.8, and 12.9; and consequential changes to paragraphs 2.8, 11.11, and 12.1.

FRS-3: Accounting for Property, Plant and Equipment (issued March 2001 and effective for periods ending on or after 31 March 2002)

SSAP-28: Accounting for Fixed Assets (issued July 1991 and effective for periods beginning on or after 1 October 1991)

The application of SSAP-3: Accounting for Depreciation (revised October 1984 and effective for periods ending on or after 31 March 1985) to assets covered by FRS-3.

FRS-3

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