Accounting Guidance Note
No. 2010/1 (Revised)

Accounting guidance notes are intended for use by Australian Government reporting entities covered by:

- S49 of the Financial Management and Accountability Act 1997; or
- Clause 2 of Schedule 1, of the Commonwealth Authorities and Companies Act 1997.

The aim of the accounting guidance notes is to provide non-mandatory explanation and examples relating to the interpretation and application of Australian Accounting Standards and the Finance Minister’s Orders to the above entities.

Accounting for Decommissioning, Restoration and Similar Provisions (‘Make Good’)

**Purpose**

To provide guidance on the accounting and disclosure requirements for initial recognition of make good provisions and subsequent changes made to them.

**Target audience**

This guidance note applies to Australian Government entities which have obligations to dismantle, remove and restore items of property, plant and equipment.

**Applicable accounting pronouncements**

- AASB 116 *Property, Plant and Equipment*;
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*; and
- AASB Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*.

**Legislative requirements**

- Division 33 *Valuation of Non-Financial Assets* of the Finance Minister’s Orders (FMOs).

**Definitions used**

A list of relevant definitions is located at Appendix 2.
Key points

1. Many agencies have obligations to dismantle, remove and restore items of property, plant and equipment (often referred to as ‘make good’). For example, agencies that lease premises may be required to restore the premises to its original condition at the conclusion of the lease.

2. Accounting standards require these obligations to be recorded as liabilities in certain circumstances, as set out in this note. They are also required to be recorded as liabilities for budget purposes (see budget implications) although funding would not normally be provided to agencies until such time as payments are required to be made.

Initial recognition and measurement of provision

3. AASB 116 requires the cost of an item of property, plant and equipment to include an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period (AASB 116.16(c)).

Examples of make good:

- **Dismantling**: the cost of taking apart a piece of machinery to allow for its removal from the site.
- **Removing**: the cost of transporting an aircraft to a disposal facility, due to a condition of purchase that it must be disposed of in a particular manner.
- **Restoration**: the cost of returning a mine site to its original condition.

Cost of an item of property, plant and equipment includes (AASB 116.16):

<table>
<thead>
<tr>
<th>Purchase price (inc. duties &amp; taxes)</th>
<th>Directly attributable costs (see AASB 116.17)</th>
<th>Initial estimate of costs of make good</th>
</tr>
</thead>
</table>

→ The following journal illustrates the initial recognition of an asset and the associated provision for make good.

Dr. Property, Plant and Equipment XX
Cr. Cash XX
Cr. Provision for make good XX
Cr. Cash/accounts payable (directly attributable costs) XX

→ Even though the above journal entry does not separate the make good proportion of the asset, entities may find it useful to show the make good proportion of the asset separately in the asset register/ledger. This will assist entities when applying revaluations and impairment requirements on the separate assets.

Note: The above credit entry to ‘cash/accounts payable (directly attributable costs)’ follows the requirement that entities assess costs when they are incurred (AASB 116.10). It would be inappropriate for entities to be initially expensing directly attributable costs at the time they were incurred and then reversing (crediting) the expense at the time of asset recognition because the assessment was not timely.

4. AASB 137 sets out how the resulting provision for decommissioning and restoration needs to be recognised and measured. An entity will be required to
establish a provision for restoration costs only when the following recognition criteria is satisfied:

a. an entity has a present obligation (legal or constructive) as a result of a past event;

b. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

c. a reliable estimate can be made of the amount of the obligation.

If these conditions are not met no provision should be recognised (AASB 137.14).

5. The amount of the provision will be the best estimate of the expenditure required to settle the present obligation at reporting date (AASB 137.36). The provision will be discounted to reflect the present value of the expenditures where the time value of money is material (AASB 137.45).

→ A common method of estimating the expenditure required to settle the obligation is to obtain a reasonable estimate of the expenditure required to make good the asset in the present day (i.e. through quotes/based on past experience in similar situations) and then adjusting this using inflationary measures such as the Consumer Price Index (CPI) or Building Price Indices to obtain the expenditure required in a future reporting period. Where the time value of money is material the provision will be discounted to reflect the present value of the expenditures (i.e. using the government bond rate).

→ Illustrative Example 1 demonstrates the estimation of expenditure required to settle the present obligation at reporting date.

6. The provision shall be reviewed at each reporting date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed (AASB 137.59).

Changes in the measurement of an existing provision

Unwinding of the discount

7. The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs; it cannot be capitalised (Interpretation 1.8). The unwinding of the provision should be recognised before revising the provision at year end.
Consider a situation where you are required to pay ABC $50,000 in 5 years time and a 10% discount rate applies. The present value of the $50,000 in today’s terms would only be worth $31,046 (i.e. if you were to invest at a rate of 10%, the $31,046 would be worth $50,000 in 5 years time).

The unwinding of the discount effectively increases the provision each year to reflect the passage of time. As in the above example, after one year has passed the entity must recognise that the $31,046 would no longer be sufficient to settle the $50,000 liability in 4 years time. The value of the $50,000 after one year would be worth $34,151 (i.e. if you were to invest at a rate of 10%, the $34,151 would be worth $50,000 in 4 years time).

Therefore the entity must increase the provision by $3,105 (the difference between $34,151 and $31,046).

→ Also see Illustrative examples 1 & 2.

**Change in provision resulting from other changes**

8. Other changes in the measurement of an existing decommissioning, restoration and similar liability result from changes in:

a. the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation; or

b. the discount rate. (Interpretation 1.4)

9. Accounting for changes in the measurement of the existing provision is dependent on the measurement of the related asset subsequent to initial recognition (cost model or revaluation model).

10. Except otherwise required the FMOs require not-for-profit entities to measure property, plant and equipment using the revaluation model (with the exception of specialist military equipment), while for-profit entities and universities may apply either the cost or revaluation model (FMOs section 33.7).

**Cost Model**

11. Under the cost model, an asset is initially measured at cost and subsequently carried at cost less accumulated depreciation and impairment losses. A subsequent increase (decrease) in the associated make good provision is added to (deducted from) the cost of the related asset in the current period.

Cost Model – increase in provision

12. Similar to the initial recognition of the make good provision, an increase in the provision leads to an increase in the cost of the related asset, as demonstrated below.

   → Dr. Property, Plant and Equipment       XX
   Cr. Provision for make good             XX

13. The increase in the cost of the asset may be an indicator that the asset may not be fully recoverable. If it is such an indication, the entity would be required to test for impairment in accordance with AASB 136 *Impairment of Assets.*
An asset is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount of the asset is the higher of its fair value less costs to sell and its value in use. For more information on impairment please see AASB 136 Impairment of Assets.

Cost Model – decrease in provision

14. A decrease in the provision leads to a reduction in the cost of the related asset. The amount of the reduction is not permitted to exceed the carrying amount of the asset. Any excess over the carrying value is taken immediately to profit or loss.

The following journal illustrates a decrease in the provision for make good:

Dr. Provision for make good    XX
Cr. Property, Plant and Equipment    XX

The deduction is not allowed to exceed the carrying amount of the asset. Take for example an entity which has revised its initial estimate of make good provision downwards by $75,000. The related asset cost $600,000 on initial recognition and as it is nearing its useful life, has accumulated depreciation of $550,000. As the amount of the deduction ($75,000) would exceed the carrying amount of the asset ($50,000), the entity will deduct $50,000 from the asset, and the excess $25,000 would be recognised in profit or loss.

Also see AASB Interpretation 1 - Illustrative Example 1, which illustrates a decrease in a decommissioning provision under the cost model.

Revaluation Model

15. Under the revaluation model, an asset is initially measured at cost and subsequently carried at fair value less any subsequent accumulated depreciation and impairment losses.

When using discounted cash flows to revalue assets for which there is a related make good provision it is important to understand whether the asset is valued on a ‘gross’ or ‘net’ basis.

If the asset is valued on a ‘gross’ basis, this means that the value of the asset has been determined without deducting any allowance for decommissioning costs. Where the asset is valued on a ‘net’ basis the value of the asset will be determined after deducting an allowance for decommissioning costs. In this case, the allowance for decommissioning costs is added back to the revalued asset.

If depreciated replacement cost (DRC) method of valuation is used and the asset is valued without including an amount relating to decommissioning costs, the DRC amount of the revalued net present value of the decommissioning costs should be added to the DRC revaluation of the asset.

Example: Three years into its useful life of ten years, an asset is revalued using DRC to $1,000. The valuer determined that the present value of the make good liability was now $100. The entity requested clarification from the valuer as to whether the $1,000 valuation was inclusive of the make good component. As it was not, the entity determined that $100, less accumulated depreciation of $30, should be added to the DRC valuation amount. The asset was therefore revalued to $1,070.

For more information see AASB Interpretation 1 Illustrative example 2.
16. Not-for-profit entities apply revaluations to a class of asset. Revaluation increases and decreases relating to individual assets within a class are allowed to be offset against one another within that class (i.e. net revaluation increase/decrease), but should not be offset by revaluations in different classes.

Practical Guidance

→ Take for example, two motor vehicles (A and B) owned by an entity under the PPE class of ‘motor vehicles’. At the end of the reporting period vehicle A is revalued downwards by $2,000, while vehicle B is revalued upwards by $3,000. As these items are in the same class of asset these revaluations can be offset, resulting in a net revaluation increase of $1,000 ($3,000-$2,000).

17. To understand changes in make good provisions under the revaluation model, it is first important to understand the treatment of previous asset revaluations, and the balance of the asset revaluation reserve. These are discussed below.

18. An increase in the carrying amount of an asset due to a revaluation must be taken to the asset revaluation reserve unless the increase reverses a previous decrease of the same asset that was previously recognised in profit or loss.

Practical Guidance

→ The following journal illustrates an increase in the carrying amount of an asset where there have been no previous revaluation decrements recognised in profit or loss:

Dr. Property Plant and Equipment XX
Cr. Asset Revaluation Reserve XX

→ The journal below illustrates an increase in the carrying amount of an asset where there has been a previous revaluation decrease recognised in profit or loss.

Dr. Property Plant and Equipment XX
Cr. Revaluation Expense XX
Cr. Asset Revaluation Reserve (excess, if any) XX

For example, an entity owns an item of PPE with an initial carrying amount of $200,000. In the previous year the asset was subject to a downwards revaluation of $20,000, which was recognised in profit or loss in that period. The entity now revalues the asset upwards by $35,000. The entity is therefore required to ‘reverse’ the previous decrement recognised in profit or loss and any excess above that amount in the revaluation reserve:

Dr. Property Plant and Equipment 35,000
Cr. Revaluation Expense 20,000
Cr. Asset Revaluation Reserve (excess) 15,000

19. A decrease in the carrying amount of an asset will be recognised in profit or loss. The decrease will be debited directly to the revaluation reserve to the extent of any credit balance existing in the respect of that asset.

Practical Guidance

→ The following journal illustrates a decrease in the carrying amount of an asset where there is no existing balance in the asset revaluation reserve.

Dr. Revaluation Expense XX
Cr. Property Plant and Equipment XX

→ The journal below illustrates a decrease in the carrying amount of an asset where there is an existing balance in the asset revaluation reserve relating to that asset:

Dr. Asset Revaluation Reserve XX
Dr. Revaluation Expense (excess, if any) XX
Cr. Property Plant and Equipment XX
Revaluation Model – Changes in the provision

20. Changes in make good provisions under the revaluation model are the reverse of revaluations of the related asset, the only difference being the account affected (asset or provision).

21. An increase in the provision for make good (similar to a revaluation decrease of the related asset) is recognised in profit or loss, except that it should be debited directly to the revaluation reserve to the extent of any credit balance existing in respect of the related asset.

→ The following journal illustrates an increase in the provision for make good where there is no existing balance in the asset revaluation reserve in respect of the related asset.

Dr. Revaluation Expense XX
Cr. Provision for make good XX

→ The journal below illustrates an increase in the provision for make good where there is an existing balance in the asset revaluation reserve in respect of the related asset.

Dr. Asset Revaluation Reserve XX
Dr. Revaluation Expense (excess, if any) XX
Cr. Provision for make good XX

22. A decrease in the provision for make good (similar to a revaluation increase of the related asset) is taken to the asset revaluation reserve unless the decrease reverses a previous revaluation decrease of the related asset that was previously recognised in profit or loss. This is subject to paragraph 23 below.

→ The following journal illustrates a decrease in the provision for make good where there have been no previous revaluation decrements of the related asset recognised in profit or loss:

Dr. Provision for make good XX
Cr. Asset Revaluation Reserve XX

→ The journal below illustrates an decrease in the provision for make good where there has been a previous revaluation decrease in the related asset recognised in profit or loss.

Dr. Provision for make good XX
Cr. Reversal of previous asset write down (income: gain) XX
Cr. Asset Revaluation Reserve (excess, if any) XX

23. If the decreases in the provision exceeds the amount that the asset would have been carried under the cost model (i.e. its depreciated cost), the excess is taken to profit or loss. This means that the maximum an asset can be reduced is the same under the cost model and the revaluation model.

24. As with the cost model, changes in the provision may be an indication that the asset (both the related asset and make good asset) may need to be revalued to ensure its carrying amount does not differ materially from its fair value at the reporting date (Interpretation 1.6c).
25. Consistent with the revaluation model requirements (para. 18-19), not-for-profit entities shall account for increases and decreases in make good provisions in relation to the class of asset and are permitted to offset these changes within the class (Interpretation 1 Aus6.1).

**Derecognising Provisions**

26. The adjusted depreciable amount of the asset is depreciated over its useful life (under both the cost and revaluation method). Where the related asset is at the end of its useful life, all subsequent changes are recognised in profit and loss (Interpretation 1.7).

**Disclosure requirements**

27. Make good provisions are a separate class of provision requiring the following disclosure under AASB 137.84:

   a. The carrying amount at the beginning and end of the period;
   
   b. Additional provisions made in the period, including increases to existing provisions;
   
   c. Amounts used (i.e. incurred and charged against the provision) during the period;
   
   d. Unused amounts reversed during the period; and
   
   e. The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

   → Illustrative examples 1 & 2 demonstrate the practical application of disclosures required under AASB 137.84.

28. In accordance with AASB 101.85 the changes in the asset revaluation reserve resulting from changes in make good provisions may be a separate line item in other comprehensive income, where entities consider it is relevant to an understanding of the entity’s financial performance.

**Budget Implications**

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Fiscal Balance</th>
<th>Underlying Cash Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Recognise provision</td>
<td>Worsen (due to movement in non-financial assets)</td>
<td>Nil impact (no effect on net cash receipts)</td>
</tr>
<tr>
<td>2. Unwinding of discount</td>
<td>Worsen (interest expense reduces net operating balance)</td>
<td>Nil impact (no effect on net cash receipts)</td>
</tr>
<tr>
<td>3. Decrease in provision (recognised in ARR)</td>
<td>Nil impact (no impact on net operating balance or non-</td>
<td>Nil impact (no effect on net cash receipts)</td>
</tr>
<tr>
<td>Financial Asset Impact</td>
<td>Decrease in Provision (recognised in P&amp;L)</td>
<td>Increase in Provision (recognised in ARR)</td>
</tr>
<tr>
<td>------------------------</td>
<td>------------------------------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>Nil impact (as decrease in provision recognised as ‘other economic flow’ there is no impact on net operating balance or non-financial assets)</td>
<td>Nil impact (no impact on net operating balance or non-financial assets)</td>
<td>Nil impact (as increase in provision recognised as ‘other economic flow’ there is no impact on net operating balance or non-financial assets)</td>
</tr>
</tbody>
</table>

1. The impact of make good is currently being reviewed by Finance in consultation with the ABS.

Note: The Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) would only record a provision where there was a legal obligation to identified counterparties or groups of counterparties.

**Contacts**

Questions or comments about this Guidance Note should be addressed to Accounting Policy Branch at accountingpolicy@finance.gov.au.
Illustrative examples

The following illustrative examples provide practical application of the accounting for decommissioning, restoration and similar provisions (‘make good’):

- Illustrative example 1: Recognition of provision to make good a building at the end of an operating lease;
- Illustrative example 2: Recognising an increase in make-good provisions in profit or loss; and
- Illustrative example 3: Recognising an increase in make-good provisions in the asset revaluation reserve.

While these examples illustrate changes in a provision resulting from a revision in the estimated amount required to settle the obligation, the same accounting requirements would be applied if the change in the provision was the result of a revision to the discount rate.

In addition, although the examples illustrate changes in a provision where the related asset is measured using the revaluation model, the same accounting requirements would be applied under the cost method except that changes in the provision would be added to or deducted from the carrying amount of the related asset, rather than recognised in the asset revaluation reserve or in profit or loss.

Illustrative example 1 – Recognition of provision to make good a building at the end of an operating lease (including illustration of disclosure requirements)

Information:

An entity enters into an operating lease for an office block on 1 July 2005 for a period of 5 years and makes $200,000 worth of leasehold improvements. The contract specifies that the entity must make good the premises at the end of the lease term. Assume the entity depreciates PPE on a straight-line basis, a discount rate of 10% applies and inflation is 4.564% at 1 July 2005.

Answer:

In accordance with AASB 116.16(c) the cost of the asset, being the leasehold improvements of $200,000, will include an estimate of the cost of making good the premises at the end of the lease.

The entity estimates that at 1 June 2005 it would cost approximately $40,000 to return the building to its original condition. To determine the expenditure required at the end of the lease (30 June 2010), the entity projects the current value using an inflationary measure (such as CPI or building index) of 4.564%.

\[
\text{Future Value} = \text{Present Value} \times (1 + \text{inflation rate})^{\text{Time period}}
\]

\[
\text{Future Value} = 40,000 \times (1 + 0.04564)^5
\]

\[
= 50,000
\]
As the time value of money is material, the provision will be discounted to its present value.

<table>
<thead>
<tr>
<th>1 July 2005 – Recognition of Asset/Provision</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Leasehold Improvements</td>
<td>231,046</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>31,046</td>
</tr>
<tr>
<td>Cr. Cash/Accounts Payable/Appropriations</td>
<td></td>
<td>200,000</td>
</tr>
<tr>
<td>$50,000 / (1.10)^5 = $31,046</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>30 June 2006 – Unwinding of discount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>3,105</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>3,105</td>
</tr>
<tr>
<td>$50,000 / (1.10)^4 - $50,000 / (1.10)^5 = 3,105</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>30 June 2007 – Unwinding of discount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>3,415</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>3,415</td>
</tr>
<tr>
<td>$50,000 / (1.10)^3 - $50,000 / (1.10)^4 = $3,415</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>30 June 2008 – Unwinding of discount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>3,756</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>3,756</td>
</tr>
<tr>
<td>$50,000 / (1.10)^2 - $50,000 / (1.10)^3 = $3,756</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>30 June 2009 – Unwinding of discount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>4,133</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>4,133</td>
</tr>
<tr>
<td>$50,000 / (1.10)^1 - $50,000 / (1.10)^2 = $4,133</td>
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</table>

<table>
<thead>
<tr>
<th>30 June 2010 – Unwinding of discount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>4,545</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>4,545</td>
</tr>
<tr>
<td>$50,000 - $50,000 / (1.10)^1 = $4,545</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>1 July 2010 – Derecognise provision</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Provision for make good</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Cr. Cash/payable</td>
<td></td>
<td>50,000</td>
</tr>
</tbody>
</table>

To derecognise provision as premises is made good
At 1 July 2010 the provision is derecognised as the premises are made good at the end of the lease. Where estimates have been incorrect and the full provision is not derecognised when the entity vacates, the provision reversal will be recognised in profit and loss, in accordance with Interpretation 1.7.

The entity will also recognise depreciation expense of $6,209 for years 1-5. This is derived from the cost of restoration included in the cost of the asset of $31,046 depreciated on a straight-line basis over the term of the lease (5 years).

<table>
<thead>
<tr>
<th>1 July 2006-10 – Depreciation of Asset</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Depreciation expense (leasehold improvements)</td>
<td>6,209</td>
<td>6,209</td>
</tr>
<tr>
<td>Cr. Accumulated depreciation (leasehold improvements)</td>
<td></td>
<td></td>
</tr>
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</table>

**Note: Other Provisions**

<table>
<thead>
<tr>
<th></th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount at 1 July 200X (opening)</td>
<td>0</td>
<td>34,151</td>
<td>37,566</td>
<td>41,322</td>
<td>45,455</td>
</tr>
<tr>
<td>Additional provisions made</td>
<td>31,046</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Provisions no longer required</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- (50,000)</td>
<td></td>
</tr>
<tr>
<td>Unwinding of discounted amount arising from the passage of time</td>
<td>3,105</td>
<td>3,415</td>
<td>3,756</td>
<td>4,133</td>
<td>4,545</td>
</tr>
<tr>
<td>Carrying amount at 30 June 200X (closing)</td>
<td>34,151</td>
<td>37,566</td>
<td>41,322</td>
<td>45,455</td>
<td>-</td>
</tr>
</tbody>
</table>

If however at 1 July 2010 the entity extends its lease at the property and therefore does not make good the property, rather than derecognising the provision the entity is required to revalue the provision to take into consideration the delay in the outflow of the resources (refer to paragraphs 8 and 9). The leasehold asset is fully depreciated therefore it will not be required to be depreciated over this new period.
Illustrative example 2 – Recognising an increase in make-good provisions in profit or loss

Information:

An entity enters into an operating lease on 1 July 2004 for a period of 20 years (i.e. until 1 July 2024). The entity makes $500,000 of leasehold improvements. The expected cost to make good the premises at the end of the lease is $100,000. A discount rate of 10% applies.

On 1 July 2008 the entity makes changes to the building, creating a number of new offices/meeting rooms, which leads to an increase of $70,000 in the expected cost to make good the premises, as the entity will now need to remove the internal structures upon vacating the premises.

In accordance with the FMOs, the entity measures PPE under the revaluation model and no credit balance exists in the asset revaluation reserve in respect to leasehold improvements.

Answer:

At 1 July 2004 the entity recognises a provision for make good of:

\[
\frac{100,000}{(1.10)^{20}} = 14,864.
\]

1 July 2004 – Recognition of provision

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Leasehold Improvements*</td>
<td>514,864</td>
</tr>
<tr>
<td>Cr. Provision for restoration</td>
<td>14,864</td>
</tr>
<tr>
<td>Cr. Cash/Accounts Payable/Appropriations</td>
<td>500,000</td>
</tr>
<tr>
<td>* $500,000 + 14,864 = $514,864</td>
<td></td>
</tr>
</tbody>
</table>

Unwinding of Discount

<table>
<thead>
<tr>
<th></th>
<th>30/06/05</th>
<th>30/06/06</th>
<th>30/06/07</th>
<th>30/06/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest Expense</td>
<td>1,487</td>
<td>1,635</td>
<td>1,798</td>
<td>1,979</td>
</tr>
<tr>
<td>Cr. Provision for restoration</td>
<td>1,487</td>
<td>1,635</td>
<td>1,798</td>
<td>1,979</td>
</tr>
<tr>
<td>Total Provision</td>
<td>16,351</td>
<td>17,986</td>
<td>19,784</td>
<td>21,763</td>
</tr>
</tbody>
</table>

See Illustrative example 1 for details of the calculation required for the periodic unwinding of the discount. I.e. the 30/06/05 calculation is \([100,000 / (1.10)^{19}] - [100,000 / (1.10)^{20}] = 1,487\)

At 1 July 2008 the entity must increase the provision to reflect the increase of $70,000 in expected cost to make good the premises. As the balance of the provision at 30 June 2008 is $21,763, the entity must recognise the difference, that being:

\[
[170,000 / (1.10)^{16}] - 21,763 = 15,234
\]

As Interpretation 1 paragraph 6(a)(ii) outlines, an increase in the liability shall be recognised in profit or loss, except where any credit balance exists in the revaluation
reserve in respect of that asset. Therefore, as no revaluations exist for the leasehold improvements, the entity must recognise the increase in the provision in profit or loss.

<table>
<thead>
<tr>
<th>1 July 2008</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Other Expenses</td>
<td>15,234</td>
<td></td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td></td>
<td>15,234</td>
</tr>
</tbody>
</table>

To recognise the increase in the provision in P&L

The entity would be required in accordance with Interpretation 1.8 and as illustrated in example 1, to recognise the unwinding of the discount in profit or loss as a finance cost as it occurs. The periodic unwinding of the discount will now be recognised in respect of the increased amount ($170,000). For example:

<table>
<thead>
<tr>
<th>Unwinding of Discount</th>
<th>30/06/09</th>
<th>30/06/10</th>
<th>30/06/11</th>
<th>30/06/12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest Expense</td>
<td>3,700</td>
<td>4,069</td>
<td>4,477</td>
<td>4,924</td>
</tr>
<tr>
<td>Cr. Provision for restoration</td>
<td>3,700</td>
<td>4,069</td>
<td>4,477</td>
<td>4,924</td>
</tr>
<tr>
<td>Total Provision</td>
<td>40,697</td>
<td>44,766</td>
<td>49,243</td>
<td>54,167</td>
</tr>
</tbody>
</table>

See Illustrative example 1 for details of the calculation required for the periodic unwinding of the discount. I.e. the 30/06/09 calculation is \(\frac{170,000}{(1.10)^9} - \frac{170,000}{(1.10)^10} = 3,700\)

The entity would also be required in accordance with AASB 116 and illustrated in example 1, to depreciate the make good included in the cost of the asset (leasehold improvements) over the term of the lease.

Note: Other Provisions

<table>
<thead>
<tr>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount at 1 July 200X (opening)</td>
<td>0</td>
<td>16,351</td>
<td>17,986</td>
<td>19,784</td>
</tr>
<tr>
<td>Additional provisions made</td>
<td>14,864</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Provisions no longer required</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Unwinding of discounted amount arising from the passage of time</td>
<td>1,487</td>
<td>1,635</td>
<td>1,798</td>
<td>1,979</td>
</tr>
<tr>
<td>Carrying amount at 30 June 200X (closing)</td>
<td>16,351</td>
<td>17,986</td>
<td>19,784</td>
<td>21,763</td>
</tr>
</tbody>
</table>

As discussed in paragraph 24, a change in the provision may be an indication that the asset (leasehold improvements and the make good asset) may need to be revalued.

When conducting a regular revaluation entities must comply with the requirements of AASB 116. In conducting regular revaluations entities must determine whether the
carrying amount of the asset is materially different from its fair value at reporting date. Where the asset is revalued this will require changes in the provision for make good.
Illustrative example 3 – Recognising an increase in make-good provisions in the asset revaluation reserve

Information:

Assume the same information as Illustrative example 2, except that there is a credit balance of $5,234 existing in the asset revaluation reserve at 1 July 2008 in respect of the leasehold improvements.

Answer:

In accordance with Interpretation 1.6(a)(ii), to the extent of any credit balance that exists in the asset revaluation reserve in respect of the leasehold improvements, the entity would be required to recognise the increase in liability in the asset revaluation reserve. As a balance of $5,234 exists in respect of leasehold improvements, the entity will be required to reduce this balance. The remaining balance will be recognised in profit or loss.

1 July 2008

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Asset Revaluation Reserve</td>
<td>5,234</td>
</tr>
<tr>
<td>Dr. Other Expense</td>
<td>10,000</td>
</tr>
<tr>
<td>Cr. Provision for make good</td>
<td>15,234</td>
</tr>
</tbody>
</table>
Appendix 2

Definitions used in Guidance Note 2010/1

- **Fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction (AASB 116.6).

- A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (AASB 137.10).

- **Property, plant and equipment** are tangible items that:
  - are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  - are expected to be used during more than one period (AASB 116.6).

- A **provision** is a liability of uncertain timing or amount (AASB 137.10).