Australian Government
Department of Finance

Accounting for subsequent expenditure on property, plant and equipment

Resource Management Guide (RMG) 113

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The words ‘**must**’, ‘**required**’, ‘**requires**’ and ‘**requiring**’ denote mandatory compliance by accountable authorities/officials. The use of the words ‘could’, ‘may’, ‘encouraged’ or ‘consider’ convey non-mandatory guidance. The guidance to which these words relate may or may not be applied by accountable authorities/officials in their approach to resource management, depending on the operating circumstances of the entity and its appetite for risk.

Contents

Audience

This guide is for use by Commonwealth entity officials (eg finance teams) with responsibility for subsequent expenditure on items of property, plant and equipment (PPE), as defined by the Australian Accounting Standards Board (AASB), Accounting Standard *AASB 116 Property, Plant and Equipment* (AASB 116).

Key points

This guide:

- explains when the cost of an item of PPE may be recognised as an asset
- defines subsequent expenditure on an item of PPE and when it occurs
- provides guidance, with illustrative examples, for determining whether subsequent expenditure on an item of PPE may be capitalised or expensed
- provides information on the budget impacts and financial statements disclosure requirements that result from subsequent expenditure on an item of PPE.

This guide replaces *Accounting for subsequent expenditure on property, plant and equipment (RMG 113)*, released November 2016.

Resources

This guide is to be read in conjunction with:

- *AASB 116 Property, Plant and Equipment*
- other relevant Australian Accounting Standards
- AASB *Framework for the Preparation and Presentation of Financial Statements*.

Introduction

1. Under paragraph 6 of *AASB 116 Property, Plant and Equipment* (AASB 116), items of property, plant and equipment (PPE) are tangible items that are:
   - held for use in the production or supply of goods or services, for rental to others, or for an administrative purpose
   - expected to be used during more than one period.
2. Subsequent expenditure on an item of PPE occurs after the acquisition/initial recognition of the item. For accounting purposes, entities need to evaluate subsequent expenditure to determine if it may be capitalised or expensed at the time incurred.

1. PPE asset recognition criteria

3. Under paragraph 7 of AASB 116, the cost of an item of PPE is recognised as an asset if, and only if:
   - it is probable that the item will provide future economic benefit for the entity
   - the cost of the item can be measured reliably.
4. AASB 116 makes no clear distinction between the initial costs of acquiring an asset and any subsequent expenditure on an item—all expenditure on an item of PPE must meet the asset recognition criteria to qualify as an asset or part of an asset.
5. Future economic benefits for not-for-profit entities include the asset's ability to contribute to the entities' objectives of delivering goods or services. For more information, see *Framework for the Preparation and Presentation of Financial Statements*.

2. Subsequent PPE expenditure to be capitalised

6. Subsequent expenditure on an item of PPE is expenditure that occurs after the acquisition/initial recognition of the item. Entities need to evaluate such subsequent expenditure to determine whether it may be capitalised or expensed at the time incurred.
7. In some cases, entities need to apply professional judgement to determine if the subsequent expenditure is capital in nature. Subsequent expenditure can only be capitalised when the asset recognition criteria has been met.
8. Where reliable cost measurement can be achieved, it is likely that the expenditure would generate future economic benefit for the entity if the purpose of the subsequent expenditure on an item of PPE is for:
   - enhancement
   - part replacement
   - major inspection, or
   - safety or environment equipment.

9. While the generation of a future economic benefit may be likely, entities will still need to determine whether it is probable that the expenditure will provide future economic benefit before expenditure is capitalised.

2.1 Enhancement

10. Generally, an enhancement to an item of PPE (such as adding a high-speed duplex unit to an existing printing facility) would increase the expected future economic benefit from the asset, for the entity. Where an enhancement increases the asset's useful life, capacity, quality or results in a reduction of operational costs for the entity, the expenditure should be capitalised.

11. Also see: Example 1: PPE enhancement not capitalised.

2.2 Part replacement

12. Parts of some items of PPE may require replacement at regular intervals. Under paragraph 13 of AASB 116, where part of an asset is replaced:

    - the replacement would be capitalised as part of the fixed asset
    - the replaced part would be derecognised, in accordance with the derecognition provisions at paragraphs 67–72 of AASB 116.

13. The cost of the replacement can be used as a guide to the original cost of the replaced part, if the cost of that part is unknown.

14. See Example 2: Accounting for PPE replacement.

2.3 Major inspection

15. Where a condition of using an item of PPE is to perform regular major inspections for faults, regardless of whether any physical parts of the asset are replaced (eg a legal requirement to inspect an aircraft after each 1,000 hours of flight), the cost incurred is capitalised. See paragraph 14 of AASB 116.

16. Inspection costs are added to the asset's cost and any carrying amount remaining from a previous inspection is derecognised. This process of recognition and derecognition should take place regardless of whether the cost of the previous inspection was identified, and considered a separate part, when the asset was originally acquired or constructed.

17. See Example 2: Accounting for PPE replacement.

2.4 Safety or environment equipment

18. The acquisition of safety or environmental equipment, which does not provide future economic benefits directly, is capitalised where it is necessary for an entity to obtain future economic benefits from its existing assets.

3. Subsequent PPE expenditure to be expensed

19. Subsequent expenditure on an item of PPE that fails to meet the asset recognition criteria at paragraph 7 of AASB 116 is to be expensed.

3.1 Servicing and maintenance

20. Under paragraph 12 of AASB 116, the day-to-day servicing of an asset (eg cleaning, minor repairs and grounds maintenance) is expenditure that should be expensed.

21. Expenditure for servicing items, often known as ‘repairs and maintenance’, is generally comprised of the costs of labour and minor parts. Such expenditure is generally routine in nature and often associated with the maintenance of the benefit in the asset.

22. Also see Example 3: Servicing an item of PPE.

4. Budget impacts and disclosure requirements

4.1 Budget implications

23. Table 1 illustrates the impact on budget aggregates of subsequent expenditure on an item of PPE where it is either capitalised or expensed.

Table 1. Impact of subsequent expenditure on fiscal and underlying cash balances

Transaction	Fiscal balance	Underlying cash balance
Subsequent expenditure – capitalising	Worsen (due to movement in non-financial assets)	Worsen (investments in non-financial assets are treated as a cash outflow)
Subsequent expenditure – expensing	Worsen (operating expenses reduce net operating balance)	Worsen (payments for goods and services are treated as an operating cash outflow)

4.2 Financial statements disclosure requirements

24. In accounting for subsequent expenditure on PPE, it is particularly important that entities apply the requirements at paragraph 73(e) of AASB 116, for the reconciliation of the opening and closing balances of PPE.

5. Illustrative examples

Example 1: PPE enhancement not capitalised

Scenario: XYZ maintains a motor vehicle fleet for delivering services to the public.

The entity keeps individual vehicles three years and then sells them through a local auction house. The value received reflects the general market conditions at the time of sale to reflect vehicles of a similar type, with equivalent kilometres travelled.

After purchasing a vehicle, XYZ decides to have a rust proofing treatment applied to extend the life of the vehicle's body by several years.

Question: Can the rust proofing be capitalised?

Answer: No. Under the asset recognition criteria at paragraph 7 of AASB 116, subsequent expenditure is only recognised if it is likely to provide the entity with future economic benefits.

In this scenario, while the rust proofing is likely to increase the useful life of the vehicle, this is unlikely to provide XYZ with future economic benefit because:

- XYZ has a policy of keeping vehicles for three years and then selling them
- the residual value of the vehicle (ie the expected sale amount) will be based on market conditions (ie vehicles of similar type and distance travelled) and not whether the vehicle has been treated to prevent rust.

Example 2: Accounting for PPE replacement

Scenario: XYZ acquired a building for its own use in January 20X0 for $10m. The building is estimated to have a useful life of 40 years.

XYZ engaged an engineer to do a structural review after purchase. Their report identified that the internal staircase was unsafe due to a building fault and would need to be replaced after five years.

XYZ replaced the stairs at a cost of $468,379 in January 20X5. The previous staircase was not identified as a separate asset when the building was acquired and it is not possible to estimate its value at that time.

Question: Can the staircase be capitalised?

Answer: Yes. Under paragraph 13 of AASB 116, if the asset recognition criteria is met, the cost of a replacement is capitalised and the previous part is derecognised.

As the new staircase is required to derive economic benefits from the building and meet safety regulations, it can be capitalised. See the journal entries at Table 2.1.

Table 2.1: Journal entries to capitalise the new staircase as part of the building

Dr/Cr	Description	Amount ($)
Dr	Asset – building	$468,379
Cr	Cash	$468,379

The previous staircase is required to be derecognised. As the original value is not known it needs to be estimated. In this case, the best indication of its value is the cost of the replacement in January 20X5, adjusted for what it would have cost in January 20X0 (using a building index or the time value of money) and the depreciation incurred during this period.

If the building costs increased by 6% p.a. over the period, the staircase would have originally cost $350,000 (being $468,379 / $(1.06)^5$) and the depreciation incurred would have been $43,750 (being $350,000 x 5/40). See the journal entries at Table 2.2 and changes to building from these journal entries at Table 2.3.

Table 2.2 Journal entries to derecognise the original staircase

Dr/Cr	Description	Amount ($)
Dr	Accumulated depreciation – building	$43,750
Dr	Loss on disposal	$306,250
Cr	Asset – building	$350,000

Note: If the replaced asset has previously been revalued, the above method may not be appropriate. A valuation may be needed to approximate the current value because the value of the stairs may not be representative of its percentage of the total fair value of the fit out.

Table 2.3 Changes to the building as a result of the journal entries at Table 2.1 and 2.2

	Asset values $	Derecognition of original staircase $	Addition of new staircase $	Closing values $
Gross value	10,000,000	(350,000)	468,379	10,118,379
Accumulated depreciation	(1,250,000)	43,750	-	(1,206,250)
Carrying amount	8,750,000	(306,250)	468,379	8,912,129

Example 3: Servicing an item of PPE

Scenario: A motor vehicle owned by XYZ is receiving an 80,000-kilometre service. The service cost $300 and replacement of the vehicle's timing belt cost $400.

Question: Can the cost for service and the new timing belt be capitalised?

Answer: The $300 service cost cannot be capitalised. Under paragraph 12 of AASB 116, servicing items, generally comprising costs of labour and minor parts, are to be expensed.

However, determining whether the timing belt is a minor part is a matter of judgement. In this scenario, it is likely that XYZ would determine the timing belt to be a minor part as its cost is not substantial and its replacement often coincides with an 80,000 kilometres service.