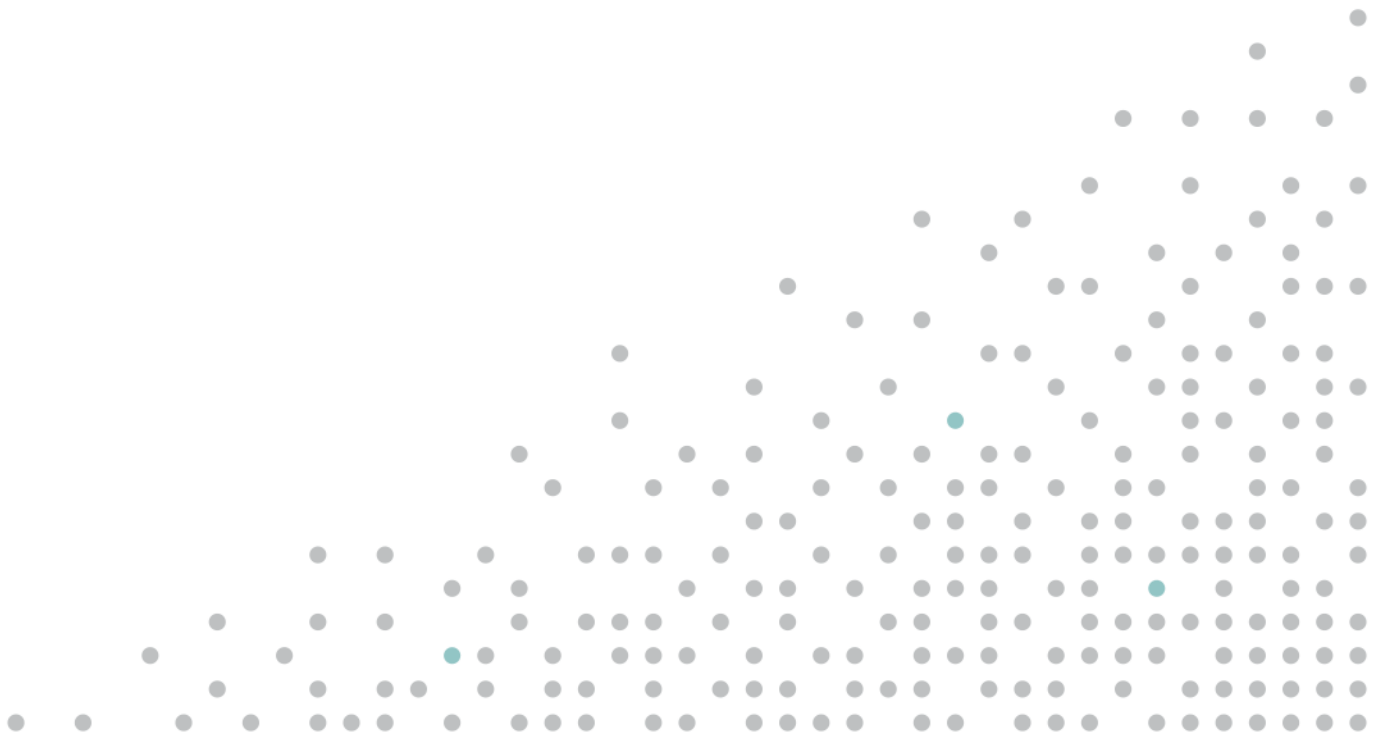




Australian Government
Department of Finance



Accounting for subsequent expenditure on property plant and equipment

Resource Management Guide No. 113

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Audience

This guide applies to all officials (e.g., finance teams) in Commonwealth entities with expenditure on property, plant and equipment within the scope of AASB 116.

This guide is designed to be read in conjunction with relevant Australian Accounting Standards.

Key points

This guide:

- **purpose:** to provide guidance on the accounting (capitalise or expense) for expenditure on property, plant and equipment after initial recognition, generally referred to as subsequent expenditure.
- **scope:** focuses on the subsequent expenditure, not the acquisition, of an AASB 116 asset.

Resource

- [AASB 116 Property, Plant and Equipment](#)

Introduction

1. Subsequent expenditure adding to, replacing part of, or servicing an item of property, plant and equipment needs to be evaluated as to whether it should be capitalised or expensed at the time it is incurred.

Part 1 – Guidance

2. AASB 116 makes no clear distinction between the initial costs of acquiring an asset and any subsequent expenditure upon it. In both cases, any and all expenditure has to meet recognition rules to qualify as an asset or part of an asset. In some cases, judgement is required to decide whether expenditure is capital in nature.
3. Subsequent expenditure should be evaluated as to whether it needs to be capitalised or expensed at the time of being incurred.

Asset recognition rules

4. Entities should capitalise the subsequent expenditure on an item of 'property, plant and equipment (PP&E)' (see 'Definitions used' below) when, and only when, the recognition criteria in paragraph 7 of AASB 116 is met (i.e., probable future economic benefits for the entity and reliable measurement).

Practical guidance

⇒ This is the same criteria for when an entity acquires PP&E.

⇒ Future economic benefits in terms of not-for-profit entities include the assets ability to contribute to the entities' objectives of delivering goods or services. See the *AASB Framework for the Preparation and Presentation of Financial Statements* for further guidance.

What subsequent expenditure can be capitalised?

5. Where reliable measurement can be achieved, the subsequent expenditure should fall under one of the following categories for there to be the possibility of probable future economic benefits for the entity:

Enhancement	Part replacement
Major inspection	Safety/Environmental

Enhancement

6. Generally, an enhancement would increase the expected future economic benefits to be obtained from the asset and therefore meet the recognition requirements. Where enhancements increase an asset's useful life, capacity, quality or result in a reduction of operational costs for the entity, these expenditures should be capitalised.

Practical guidance

⇒ For example, the addition of a high speed duplex unit to an existing printing facility.

⇒ See **Illustrative example 1** for an example of an enhancement that should not be capitalised.

Part replacement

7. Where part of an asset is replaced, the replacement part would be capitalised as part of the fixed asset and the replaced part would be derecognised regardless of whether it has been depreciated separately.

Practical guidance

⇒ The cost of a replacement part can be used as a guide to the original cost of the replaced part, if the cost of that part is unknown (see **Illustrative example 2**).

Major inspection

8. Where a condition of using the asset is to perform regular major inspection for faults, regardless of whether any physical parts of the asset are replaced, the cost incurred is capitalised.

Practical guidance

⇒ For example, if there was a legal requirement to inspect aircraft every 1,000 hours.

9. 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/constructed.

Practical guidance

⇒ The approach taken in **Illustrative example 2** may also apply to major inspections.

Safety or environmental equipment

10. The acquisition of safety or environmental equipment, which do not provide future economic benefits directly are capitalised where they are necessary for an entity to obtain future economic benefits from its existing assets.

When should subsequent expenditure be expensed?

11. Expenditure should be expensed when it fails to meet the asset recognition criteria highlighted in paragraphs 4 and 5 above.

Servicing

12. A specific expenditure item that should be expensed is the day-to-day servicing and maintenance of an asset (generally referred to as 'repairs and maintenance'). This expenditure item comprises primarily of the costs of labour and minor parts. These types of expenditure are routine in nature and are often associated with the maintenance of the benefit in the asset.

Practical guidance

⇒ For example, cleaning expenses, minor repairs and grounds maintenance. See also **Illustrative example 3**.

Part 2 – Disclosure requirements

13. Entities should be aware of the disclosure requirements for PP&E in AASB 116, in particular the reconciliation of the opening and closing balances of PP&E.

Part 3 – Budget implications

14. The following table illustrates the impact on budget aggregates of subsequent expenditure on PP&E where it is either capitalised or expensed:

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

Part 4 – Definition used

- Property, plant and equipment are tangible items that:
 - (a) are held for use in production or supply of goods or services, for rental to others, or for administrative purposes; and
 - (b) are expected to be used during more than one period (paragraph 6 of AASB 116).

Appendix 1 – Illustrative examples

Illustrative example 1: Enhancement

Information:

XYZ maintains a motor vehicle fleet for use in delivering services to the public. Individual vehicles are kept for three years and then sold through a local auction house. The value received reflects the general market conditions at the time of sale for vehicles of similar type with equivalent kilometres travelled.

The entity decides subsequently to treat all of its vehicles with a rust proof treatment that will extend the life of the motor vehicles body by several years.

Can the rust proofing be capitalised?

Answer:

No.

The basic principle is that the rust proofing should be capitalised, only if it results in future economic benefits for XYZ.

While the rust proofing increases the useful life of the car it does not increase its useful life for XYZ as XYZ has a policy of keeping vehicles for three years and then selling them.

The rust proofing does not affect the residual value of the asset (the amount expected from its sale) as this is based on market conditions in relation to the type of car and distance it has travelled, rather than whether it has been treated for the prevention of rust.

The expenditure therefore while enhancing the asset would not be capitalised.

Illustrative example 2: Part replacement

Information:

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 staircase was not identified as a separate asset when the building was acquired and it is not possible to estimate its value at this time.

Can the staircase be capitalised?

Answer:

Yes.

Under paragraph 13 of AASB 116 the cost of a replacement is capitalised and the previous part derecognised, when it meets the asset recognition criteria. The staircase is required for XYZ to derive economic benefits from the building and also under safety regulations, it is therefore capitalised. The journal entry to capitalise the new staircase as part of the building is:

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 costed in January 20X0 (i.e., using a building index or the time value of money) and for the depreciation incurred during this period.

If the building costs increased by 6% p.a. over the period, the staircase would have an original cost of \$350,000 (being $\$468,379 / (1.06)^5$) and the depreciation incurred would have been \$43,750 (being $\$350,000 \times 5/40$). The journal entry to derecognise the original staircase is:

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 then the method demonstrated above may not be appropriate, a valuation might be needed to approximate the current value. This is due to the value of the stairs not being representative of its percentage of the total fair value of the fitout.

The following table illustrates the change to the building from the above journals:

	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

Illustrative example 3: Servicing

Information:

A motor vehicle owned by XYZ is receiving an 80,000 kilometre service. The service cost \$300 and a replacement timing belt cost \$400.

Can the servicing costs and replacement timing belt be capitalised?

Answer:

No.

AASB 116 specifies the cost of day-to-day servicing being generally the costs of labour and minor parts are expensed. In this case the service costs of \$300 would be expensed.

To determine whether the timing belt is a minor part is a matter of judgement. In this case, we would consider that the timing belt would be a minor part as its cost is not substantial and would generally be incurred as part of a general service of a car after 80,000 kilometres.