Accounting for decommissioning, restoration and similar provisions (‘make good’)

Resource Management Guide No. 114

NOVEMBER 2016
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Audience

This guide applies to all officials (e.g. finance teams) in Commonwealth entities that have obligations to dismantle, remove and restore items of property, plant and equipment.

*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 and disclosure requirements for initial recognition of make good provisions and subsequent accounting, including the unwinding of the discount and changes made to the provision.

- **scope**: whilst the focus is on accounting for make good provisions, limited guidance is also provided on accounting for the related asset as support. In principle, the discounting guidance can also apply to other AASB 137 provisions.

Resources

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

1. Make good costs include the initially estimated costs involved in dismantling, removing and restoration, where the obligation was incurred either when the item was acquired or as a consequence of having used the item.

2. The initial measurement of the provision of make good costs is the present value of the estimated expenditures required to settle the present obligation at the end of the financial reporting period.

3. An entity needs to choose either the cost model or the revaluation model for the subsequent measurement of each class of property, plant and equipment.

4. If the cost model was chosen, an increase (or a decrease) in the provision leads to an increase (or a reduction) in the cost of the related asset.

5. If the revaluation model was elected, an increase (or a decrease) in the provision is generally recognised in profit or loss (the asset revaluation reserve) where there is no existing balance in the asset revaluation reserve or revaluation decrement previously recognised in profit or loss.

6. The adjusted depreciable amount of the asset is depreciated over its useful life (under both the cost and revaluation models). Where the related asset is at the end of its useful life, all subsequent changes to the provision are recognised in profit or loss as they occur.

Part 1 – Guidance

7. Many entities have obligations to dismantle, remove and restore items of ‘property, plant and equipment (PP&E)’ (see ‘Definitions used’ below), often referred to as ‘make good’ (e.g., entities that lease premises may be required to restore the premises to its original condition at the conclusion of the lease).

8. Accounting standards require these obligations to be recorded as ‘liabilities’ (see ‘Definitions used’ below, see also ‘provisions’) in certain circumstances, as set out in this Guide. They are also required to be recorded as liabilities for budget purposes (see ‘Budget implications’ below) although funding would not normally be provided to entities until such time as payments are required to be made.

The provision to make good

Initial recognition

9. The cost of an item of PP&E includes (as per paragraph 16 of AASB 116):

| Purchase price (incl. duties & taxes) | Directly attributable costs (see paragraph 17 of AASB 116) | Make good costs (see paragraphs 10-13 of this Guide) |
The following journal illustrates the initial recognition of an asset and the associated provision for make good:

Dr. PP&E* XX
Cr. Cash/Accounts payable/Appropriations (as appropriate) XX
Cr. Cash/Accounts payable etc. (directly attributable costs)^ XX
Cr. Provision for make good XX

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

^This entry to ‘cash/accounts payable etc. (directly attributable costs)’ follows the requirement that entities assess costs when they are incurred (paragraph 10 of AASB 116).

10. Make good costs include the initially estimated costs involved in dismantling, removing and restoration, where the obligation was incurred either when the item was acquired or as a consequence of having used the item (paragraph 16 (c) of AASB 116).

Examples of make good costs:
- **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.

11. The resulting provision for make good is only recognised when the criteria in paragraph 14 of AASB 137 is satisfied, i.e., there is a present obligation, a probable outflow of resources and the amount can be reliably estimated.

**Initial measurement**

12. The initial measurement of the provision is the best estimate of the expenditure required to settle the present obligation at the end of the financial reporting period in accordance with paragraphs 36 – 52 of AASB 137 (including consideration of paragraph 13 of this Guide). The result is the amount recognised as the make good component of the asset in the journal entry in paragraph 9 of this Guide.

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.
13. Where the time value of money (TVOM) is material, the provision is discounted to reflect the present value of the estimated expenditures (using a pre-tax rate, such as the government bond rate) (see practical guidance to paragraph 14 of this Guide). In other words, if the TVOM is not material then discounting would not be required.

Subsequent accounting

FIRST: Unwinding of the discount (where TVOM is material)

14. The periodic unwinding of the discount increases the carrying amount of the provision to make good and is recognised in profit or loss (P&L) as a ‘finance cost’ as it occurs; AASB Interpretation 1 disallows capitalisation. The unwinding of the provision should be recognised before revising the provision at year end.

Consider Appendix 1 Illustrative example 1 – $50,000 is to be paid in five years’ time (year 20X5) to make good a premises and a 10% discount rate applies. The value of $50,000 in today’s terms (year 20X0) would only be $31,046 (i.e., if you were to invest at a rate of 10%, the $31,046 would be worth $50,000 in 20X5) (relevant to paragraph 13 of this Guide). The unwinding of the discount effectively increases the provision each year to reflect the passage of time. After one year has passed, $31,046 is no longer sufficient to settle the $50,000 liability in four years’ time. The value of $50,000 after one year would now be $34,151 (i.e., if you were to invest at a rate of 10%, $34,151 would be worth $50,000 in 20X5). Therefore, the entity must increase the provision by $3,105 (the difference between year 20X1’s present value of $34,151 and year 20X0’s $31,046).

SECOND: Changes in the measurement of an existing provision to make good

15. Entities are required to review the provision at each reporting date and make adjustments to reflect the provision’s current best estimate. If it is no longer probable that the entity will be required to settle the obligation, the provision is reversed.

16. Changes in the measurement of a make good provision may result from changes in the estimated timing or amount required to settle the obligation; or the discount rate.

Consider Appendix 1 Illustrative example 1 – at the end of the

\[ \text{Practical guidance} \]

\[ \begin{align*}
20X5: & \quad $50,000 \\
20X4: & \quad $45,455 \\
20X3: & \quad $41,322 \\
20X2: & \quad $37,566 \\
20X1: & \quad $34,151 \\
20X0: & \quad $31,046 \\
\end{align*} \]

1 For other AASB 137 provisions, this would instead be a ‘borrowing cost’ per paragraph 60 of AASB 137 and thus be subject to section 15 of the FRR.
lease term the entity instead extends its lease and hence does not make good the property at this point in time. Rather than derecognising the provision, the entity would be required to revalue the provision to take into consideration this delay. As the leasehold asset is fully depreciated, there would be no further depreciation over this new period.

Cost model and revaluation model

17. Entities must account for changes in the measurement of the existing provision in accordance with AASB Interpretation 1. Accounting for such changes is dependent on the measurement of the related asset subsequent to initial recognition (either the cost model or the revaluation model as limited by the requirements of section 17 of the Public Governance, Performance and Accountability (Financial Reporting) Rule 2015 (FRR)). Both models are discussed below in relation to the provision to make good and its related asset.

Cost model

18. Related assets may be accounted for as per the cost model within AASB 116. The impact of a change in the associated make good provision on the related asset is as follows:

An increase (or decrease) in the provision is added to (or deducted from*) the cost of the asset.

An increase in the asset’s cost may indicate that the asset is not fully recoverable. Therefore, testing for impairment would be considered under AASB 136 Impairment of Assets.

*See paragraph 21 of this Guide for exception.

Changes in the provision to make good

19. Similar to the initial recognition of the make good provision in paragraph 3 of this Guide, an increase in the provision leads to an increase in the cost of the related asset, as demonstrated:

Dr. PP&E XX
Cr. Provision for make good XX

20. A decrease in the provision leads to a reduction in the cost of the related asset, as demonstrated (subject to paragraph 21 of this Guide):

Dr. Provision for make good XX
Cr. PP&E XX
21. However, the amount of the reduction is not permitted to exceed the carrying amount of the asset. Any excess is taken immediately to P&L.

For example, an entity 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 the end of its useful life, has accumulated depreciation of $550,000. As the amount of the deduction ($75,000) exceeds the carrying amount of the asset ($50,000), the entity deducts $50,000 from the asset, and the excess $25,000 is recognised in P&L.

Revaluation model

22. Related assets may be accounted for as per the revaluation model within AASB 116. Entities to note the following:

- PP&E revaluations apply to a class of assets (not-for-profit entities).
- the basis of a valuation obtained for such assets (i.e., whether an allowance for make good has been included/excluded in the valuation) affects the procedures that may be required to avoid double counting.

Paragraph IE7 of AASB Interpretation 1 Illustrative example 2 provides information on the treatment where entities have used either the discounted cash flows (DCF) or the depreciated replacement cost (DRC) valuation method. The Illustrative example also provides further information for the DCF method’s ‘net’ valuation approach.

DRC method 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 valuer informed the entity that the $1,000 valuation was exclusive of the make good component. Therefore, 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.

23. To understand changes in make good provisions under the revaluation model, it is first important for entities to understand the treatment of previous asset revaluations (if any), and the balance of the asset revaluation reserve (ARR). As this is required for all PP&E under the revaluation model, it is only discussed very briefly in paragraphs 24 to 29 of this Guide.

24. For not-for-profit entities, an increase in the carrying amount of a class of assets due to a revaluation must be taken to the ARR. However, to the extent of the increase reversing a previous decrease of the same class of assets previously recognised in P&L, the increase should be credited directly to P&L.
25. For not-for-profit entities, a decrease in the carrying amount of a class of assets due to a revaluation will be recognised in P&L. However, to the extent of any credit balance existing in the ARR in respect of that same class of assets, the decrease should be debited directly to the ARR.

26. The impact of a change in the associated make good provision on the related asset is as follows:

An increase (a decrease) in the provision is recognised in P&L* (other comprehensive income (OCI) and increases the ARR^).

A change in the provision may indicate that the related asset should be revalued. Any such revaluation is taken into account in determining the amounts to be recognised in P&L or OCI. If a revaluation is necessary, all assets of that class are required to be revalued.

*See paragraph 28 of this Guide for an exception.
^See paragraphs 29 and 30 of this Guide for exceptions.

Changes in the provision to make good

27. 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). Again, for NFP entities the requirements are applied in relation to a class of assets consistent with that for the revaluation model.

28. An increase in the provision (similar to a revaluation decrease of the related asset in paragraph 19 of this Guide) is recognised in P&L and, to the extent of any credit balance
existing in the ARR in respect of the related asset, the increase is debited directly to the ARR.

Practical guidance

Rightarrow The following journal illustrates an increase in the provision where there is an existing balance in the ARR in respect of the related asset:

Dr. ARR* XX
Dr. Revaluation expense (excess, if any) XX
Cr. Provision for make good XX

*Where there is no existing balance in the ARR in respect of the related asset, this account is excluded.

Appendix 1 Illustrative examples show the accounting for increases in the provision where there is (Illustrative example 3)/is not (Illustrative example 2) an existing credit balance in the ARR.

29. A decrease in the provision (similar to a revaluation increase of the related asset in paragraph 24 of this Guide) is taken to the ARR and, to the extent of the decrease reversing a previous revaluation decrease of the related asset that was previously recognised in P&L, the decrease is credited to P&L as a reversal. This is subject to paragraph 30 of this Guide.

Practical guidance

Rightarrow The following journal illustrates a decrease in the provision where there has been a previous revaluation decrease in the related asset recognised in P&L:

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

*Where there has been no previous revaluation decrement of the related asset recognised in P&L, this account is excluded.

30. If the decrease 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 P&L. This means that the maximum an asset can be reduced is the same under both models.

Derecognising provisions

31. The adjusted depreciable amount of the asset is depreciated over its useful life (under both the cost and revaluation models). Where the related asset is at the end of its useful life, all subsequent changes to the provision are recognised in P&L as they occur.

Practical guidance

Rightarrow For example, consider Appendix 1 Illustrative example 1 – the provision has been fully derecognised at 1 July 20X5 as the premises is made good. If the estimates were incorrect and the full provision was not derecognised when the entity vacated, a provision reversal would be recognised in P&L.
32. Derecognition of the related asset is carried out in accordance with paragraphs 67 - 72 of AASB 116. Additionally, assets carried under the revaluation model have an option through paragraph 41 of AASB 116 which provides entities with the choice upon derecognition to transfer the ARR that specifically relates to that asset directly to retained earnings, and such transfers are not made through P&L.

**Part 2 – Disclosure requirements**

33. Make good provisions are a separate class of provisions to be disclosed as per the requirements of AASB 137. Comparative information of the ‘movement schedule’ is not required (paragraph 84 of AASB 137).

Practical guidance ➔ **Appendix 1 Illustrative examples 1 and 2** demonstrate the practical application of disclosures required under the ‘movement schedule’.

34. In accordance with paragraph 85 of AASB 101 *Presentation of Financial Statements*, the changes in the ARR resulting from changes in make good provisions may be a separate line item in OCI, where entities consider it is relevant to an understanding of the entity’s financial performance.

**Part 3 – Budget implications**

35. The following table illustrates the impact on budget aggregates of transactions at different stages in the lifecycle of a make good provision:

<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 (NFAs))</td>
<td>Nil impact (no cash inflow/outflow)</td>
</tr>
<tr>
<td>2. Unwinding of the discount</td>
<td>Worsen (interest expense reduces net operating balance)</td>
<td>Nil impact (no cash inflow/outflow)</td>
</tr>
<tr>
<td>3. Changes in the provision due to revaluation</td>
<td>Nil impact (if a change in provision due to revaluation can be recognised, such change is treated as ‘other economic flow’)</td>
<td>Nil impact (no cash inflow/outflow)</td>
</tr>
<tr>
<td>4. Changes in the provision impacting P&amp;L and/or Balance Sheet</td>
<td>Worsen (if, increase) or Improve (if, decrease)</td>
<td>Nil impact (no cash inflow/outflow)</td>
</tr>
<tr>
<td>5. Make good cash payments</td>
<td>Nil impact (no impact on net operating balance from operations or NFAs)</td>
<td>Worsen (decrease in cash resulting from restoration/decommissioning)</td>
</tr>
</tbody>
</table>

Note: The ABS Government Finance Statistics would only record a provision where there was a legal obligation to identified counterparties or groups of counterparties.
Part 4 – Definitions used

- **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 (paragraph 10 of AASB 137).

- **Property, plant and equipment** are tangible items that:
  - (a) are held for use in the 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).

- **A provision** is a liability of uncertain timing or amount (paragraph 10 of AASB 137).
Appendix 1

Illustrative examples

The following examples provide practical application of accounting for make good:

**Illustrative example 1**: Recognition and subsequent accounting of make good provision (including disclosure);

**Illustrative example 2**: Recognising an increase in make good provisions where there is no credit balance in the asset revaluation reserve (ARR) (including disclosure); and

**Illustrative example 3**: Recognising an increase in make good provisions where there is a credit balance in the ARR.

Supplementary application of Illustrative examples 2 and 3

While Illustrative examples 2 and 3 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.

Additionally, 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 model except that changes in the provision would be added to/deducted from the carrying amount of the related asset, rather than recognised in the ARR/P&L.
Illustrative example 1: Recognition and subsequent accounting of make good provision (including disclosure)

Information:

An entity enters into an operating lease for an office block on 1 July 20X0 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.

The $200,000 cost of the asset (leasehold improvements) will include an estimate of the cost of making good the premises at the end of the lease. The entity estimates that at 1 July 20X0 it would cost approximately $40,000 to return the building to its original condition. This estimate is based on obtaining quotes for the estimated level of work required and past experience.

Assume the entity depreciates PP&E on a straight-line basis, the time value of money is material, a discount rate of 10% applies, and inflation is 4.564% at 1 July 20X0.

Answer:

Initial accounting

To determine the expenditure required at the end of the lease (30 June 20X5), the entity projects the current value of the $40,000 using an inflationary measure of 4.564% as follows:

\[
Future \ value (FV) = \frac{Present \ Value \times (1 + inflation \ rate)^{Time \ period}}{Time \ period} = \frac{$40,000 \times (1.04564)^5}{5} = $50,000
\]

As the time value of money is material, the $50,000 provision is discounted to its present value (PV) (see the practical guidance to paragraph 8 of this Guide for further explanation as it relates to this Illustrative example). The following formula shows the process that was applied in calculating the PV:

\[
Present \ value (PV) = \frac{FV}{(1 + discount \ rate)^{Time \ period \ remaining}} = \frac{$50,000}{(1.10)^5} = $31,046
\]

At 1 July 20X0, the following journal is posted to recognise the asset and its associated provision:

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leasehold improvements (asset)</td>
<td>Cash</td>
<td>$200,000</td>
</tr>
<tr>
<td></td>
<td>Provision for make good</td>
<td>$31,046</td>
</tr>
</tbody>
</table>

Subsequent accounting

Over the life of the lease term, the discount is unwound to the full $50,000 (as per above, see the practical guidance to paragraph 8 of this Guide as it relates to this Illustrative example). The following formula is repeated in this process through to the end of the lease term:

\[
Increase \ in \ provision = (PV \ for \ current \ year) - (PV \ for \ prior \ year)
\]

E.g., for 30/06/X1

\[
= \frac{$50,000}{(1.10)^4} - $31,046 = $3,105 \ etc.
\]
The entity will also recognise depreciation expense of $6,209 for years 1-5 in relation to make good. 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).

At the end of the lease the provision is derecognised as the premises is made good.

Disclosure

The movement schedule disclosures that are required for each year are as follows:

Note X: Other Provisions [extracts for 20X1 – 20X5]
Illustrative example 2: Recognising an increase in make good provisions where there is no credit balance in the ARR (including disclosure)

Information:

Assume the same information as Illustrative example 1, however assume that at 1 July 20X2 the entity makes changes to the building, creating a small number of new offices/meeting rooms, which leads to an increase of $20,000 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 FRR, the entity measures PP&E under the revaluation model and no credit balance exists in the ARR in respect to leasehold improvements.

Answer:

Up until 30 June 20X2 (inclusive), the same accounting treatment as in Illustrative example 1 applies.

At 1 July 20X2 the entity must increase the provision to reflect the increase of $20,000 in expected cost to make good the premises. As the balance of the provision at 30 June 20X2 is $37,566 (calculated in Illustrative example 1), the entity must recognise the difference, that being:

\[
\text{Increase in provision} = \left(\frac{70,000}{(1.10)^2}\right) - 37,566 = 15,026
\]

Dr. Revaluation expense $15,026
Cr. Provision for make good $15,026

To recognise the increase in the provision in P&L (now $52,592)

The entity would be required (as in Illustrative example 1) to recognise the unwinding of the discount in P&L as a finance cost as it occurs. The periodic unwinding of the discount will now be recognised in respect of the increased amount ($70,000), as follows:

<table>
<thead>
<tr>
<th></th>
<th>30/06/X3</th>
<th>30/06/X4</th>
<th>30/06/X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Interest expense</td>
<td>5,259</td>
<td>5,785</td>
<td>6,364</td>
</tr>
<tr>
<td>Cr. Provision for make good*</td>
<td>5,259</td>
<td>5,785</td>
<td>6,364</td>
</tr>
<tr>
<td>Unwinding of the discount</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total provision (i.e. 52592 + 5259)</td>
<td>57,851</td>
<td>63,636</td>
<td>70,000</td>
</tr>
</tbody>
</table>

*See Illustrative example 1 for further details on the periodic unwinding of the discount. For example, the calculation to increase the provision at 30/06/X3 = ($70,000 / (1.10)^2) –$52,592 = $5,259 etc.

The entity would also be required to depreciate the make good included in the cost of the asset (leasehold improvements) over the term of the lease (as in Illustrative example 1 but adjusted from the 20X2-X3 reporting period (see the Illustrative examples in Interpretation 1 for guidance)).
As the premises is made good at the end of the lease, a journal entry similar to that in Illustrative example 1, but for $70,000, is required.

Note: As discussed in paragraph 20 of this Guide, a change in the provision may be an indication that the asset (leasehold improvements and the make good asset) should be revalued. When conducting a regular revaluation, entities must comply with the requirements of AASB 116. Essentially, entities need to determine whether the asset’s carrying amount 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.

Disclosure

The movement schedule disclosures required for the remaining three years are now as follows:

Note X: Other Provisions [extracts for 20X3 – 20X5]

<table>
<thead>
<tr>
<th></th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 1 July 20XX</td>
<td>38</td>
<td>58</td>
<td>64</td>
</tr>
<tr>
<td>Additional provisions made</td>
<td>15</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Amounts used</td>
<td>-</td>
<td>-</td>
<td>(70)</td>
</tr>
<tr>
<td>Unwinding of discount or change in discount rate</td>
<td>5</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Total as at 30 June 20XX</td>
<td>58</td>
<td>64</td>
<td>-</td>
</tr>
</tbody>
</table>

Illustrative example 3: Recognising an increase in make good provisions where there is a credit balance in the ARR

Information:

Assume the same information as Illustrative example 2, except that there is a credit balance of $5,026 existing in the ARR at 1 July 20X2 in respect of the leasehold improvements.

Answer:

Excluding the journal entry at 1 July 20X2, the same accounting treatment as in Illustrative example 2 applies.

At 1 July 20X2, to the extent of the credit balance that exists in the ARR in respect of the leasehold improvements ($5,026), the entity would be required to recognise the increase in liability in the ARR. The remaining amount will be recognised in P&L.

Dr. Asset revaluation reserve $5,026
Dr. Revaluation expense ($15,026 – $5,026) $10,000
Cr. Provision for make good $15,026

To recognise the increase in the provision in ARR with the excess going to P&L