publications

Deloitte Touche Tohmatsu

Accounting Alert

A Focus on Technical Accounting Issues - Issue Number 7

- Changes proposed by ED-82 accounting for plant, propoerty and equipment
- IAS19 - employee benefits, authoritative support?

- Previous Accounting Alert newsletters

Changes proposed by ED-82 accounting for property, plant and equipment

The new exposure draft will replace SSAP-3: *Accounting for Depreciation* and SSAP-28: *Accounting for Fixed Assets*. The principles contained in the exposure draft are largely consistent with the corresponding Australian and International Accounting Standards.

ED-82 provides guidance on all aspects of accounting for items of property, plant and equipment with the exception of investment properties which are accounted for under SSAP-17.

Significant changes are:

- Infrastructural assets are now to be depreciated. There is a proposed transitional provision allowing an additional two years for entities with infrastructural assets to comply with the provisions of the standard in relation to depreciation, subsequent expenditure and impairment. (A further transitional provision requires any one-off adjustment in applying the standard for the first time to be recognised in the statement of movements in equity against opening equity.)

- Donated or subsidised assets are to be initially recognised at their fair value including any acquisition costs to bring the asset into a workable condition. The exposure draft does not permit donations or subsidies to be credited against the cost of the asset. The credit must be reflected as revenue in the Statement of Financial Performance. This is consistent with the Statement of Concepts for General Purpose Financial Reporting.

- Directly attributable financing costs must be capitalised to the cost of the particular item of property, plant or equipment. SSAP 28 merely indicated that finance costs may be capitalised. There is a differential reporting exemption in this regard. Guidance is given on what finance costs are to be capitalised as well as the commencement and cessation of capitalisation. This guidance is provided because there is no New Zealand standard dealing with borrowing costs. The principles are consistent with International Accounting Standard - IAS 23 (although the benchmark treatment in IAS 23 is to expense financing costs with capitalisation being an allowed alternative).

- Where an entity has elected to revalue items of property, plant and equipment which are no held for resale the valuation must be on the **existing use basis**.

The principles embodied within the revaluation framework are consistent with the methodology and terminology used by the New Zealand Institute of Valuers.

- Valuations must be at 'market value for the existing use'. If no market value can be determined, the item is to be valued at its (optimised) depreciated replacement cost.

- Revaluation increments and decrements within a class of asset are required to be offset, bu the total of increments and the total of decrements by class are required to be disclosed. The requirement that no item of property, plant or equipment is to be included at a valuation that was determined more than three years previously, still applies.

- Specialised assets are be revalued at depreciated replacement cost. Depreciated replacement cost is defined as:

  - in the case of property, the current market value for the existing use of land, plus the current gross replacement cost of improvements, less allowances for physical deterioration and all relevant forms of obsolescence and optimisation; and

  - for plant and equipment, the current gross replacement cost reduced by factors providing for age, physical deterioration and technical and functional obsolescence, taking into account the item's total estimated useful life and residual value.

- Disposal costs are not to be deducted in determining the value of an item of property plant and equipment unless there is an intention to sell the item.

- The exposure draft adopts the view that most items of property, plant and equipment are no specialised and are therefore capable of being sold in their own right.

  - *Examples of assets that are not considered specialised include industrial complexes, churches, police stations and post offices. These assets if revalued should be valued using the market value for existing use, rather than depreciated replacement cost.*

- Previously under SSAP28, once an entity elected to revalue a class of assets, it was required to continue to do so. The maximum period between revaluations was 3 years. ED 82 proposes to allow entities to stop revaluing without reverting to the original historical cost of the asset. The carrying value will be the last valuation less provision for depreciation to balance date. Entities adopting this provision will be required to disclose the change in measurement base as a change in accounting policy in accordance with FRS-1: *Disclosure of Accounting Policies.* They will also be required to disclose whether the measurement base has been changed previously and, if so, when.

- An annual impairment review is required by ED-82. Under SSAP 28, an impairment was only recognised when there was a ***permanent*** *impairment*. The exposure draft simply refers to an *impairment*. An impairment loss is the amount by which the carrying value of an asset exceeds its recoverable amount. Recoverable amount is the **greater** of *net market value* and *value in use*.

  - *Value in use is calculated by reference to the future cash flows that are expected to be generated by the asset including the residual value discounted from the expected date of disposal. No guidance is given specifically on what discount rate to use in the present value calculation. However, in this regard we believe that the rate should be the asset -specific rate of return expected from the market.*

Each asset should be reviewed at each reporting date to assess whether there is any indication that an impairment exists.

New disclosures required:

- Details of property, plant and equipment not in current use.
- Where the net market value of land and buildings is materially different from the carrying amount, an estimate of the net market value must be disclosed.
- The net market value of items of plant and equipment may be materially different from the carrying amounts (eg: depreciated historical cost). If an indication of the net market value of such items is available and would enhance the usefulness of the financial report, an estimate of the net market value should be disclosed.
- Total of impairment losses recognised and the total reversed during the reporting period.
- Details of any changes in depreciation rates and/or methods and the financial effect of such changes.
- Disclosure of a change in measurement base, including the reason for the change and financial effect. In addition any previous changes in measurement bases and the dates will also need to be disclosed.
- Details of capital commitments and commitments for future expenditure on repairs and maintenance and the extent to which previously planned expenditure has not been incurred
- Disclosure of the residual value of each class.
- Details of any one off adjustment required to comply with the standard in the first year of application.

Submissions on ED-82 are required by 31 August 1998 and can be made to the Director - Accounting and Professional Standards, Institute of Chartered Accountants of New Zealand, PO Box 11 342 or by e-mail to april_mackenzie@icanz.co.nz.

IAS19 – Employee benefits – authoritative support?

The IASC has recently revised IAS19 dealing with employee benefits. The new standard replaces IAS19, Retirement Benefit Costs which was approved in 1993. IAS19 (revised) becomes operative for financial statements covering periods beginning on or after 1 January 1999.

The Standard has been based on principles consistent with the application of New Zealand's Statement of Concepts. Australia is in the process of harmonising their Employee Entitlements Standard with IAS19 (revised). Accordingly, this Standard should be adopted in New Zealand on the basis that IAS19 (revised) is arguably authoritative support.

Some of the principles are already embodied within the international exposure draft E61 - Business Combinations, and it is likely that these principles will also be included in the New Zealand exposure draft on Business Combinations which is shortly to be issued by the Institute.

Five categories of employee benefits are identified, namely:

- short-term employee benefits

- post-employment benefits
- other long-term employee benefits
- termination benefits
- equity compensation benefits

Employee benefits therefore include all forms of consideration given by an entity in exchange for services rendered by employees.

Key requirements of the Standard include:

Current service costs

- Current service cost should be recognised as an expense when the employee has renderec service to the entity. Short term benefits include paid sick pay, paid annual leave and other benefits. In this regard, entities should be providing at balance date for holiday pay outstanding as well as any accumulating sick pay not paid out at year end.

Post employment benefits - Defined Benefit Plans

- Where an entity has provided post employment benefits to its employees in the form of a defined benefit plan, it is required to use the Projected Unit Credit Method to measure its pension expense and related obligation. This is an accrued benefit method. Projected benefit methods may not be used.

- An entity should determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at balance date.

  - A 10% corridor should be used for actuarial gains and losses on both the underlying benefit obligations and any related plan assets. Where the cumulative unrecognised amount exceeds 10% of the gross obligation or 10% of the fair value of the plan assets, the excess must be amortised over a period not longer than the estimated average remaining working lives of the employees participating in the plan.

  - The corridor is an effective way of ensuring that changes in post-employment benefits liabilities are only recognised when they are sufficiently reliable to justify recognition and fall outside a tolerable range.

- Plan assets should be measured at market value, with changes in the market value subject to the 10% ‘corridor’ for actuarial gains and losses.

- A net pension asset in the Statement of Financial Position may not exceed the present value of available funds plus the available reduction in future contributions due to a plan surplus. Plan assets that exceed the related benefit obligations should be recognised if:

  - the entity controls the resource, which is the ability to use the surplus to generate future benefits,

  - that control is a result of past events (contribution paid by the enterprise and service rendered by the employee), and

- future economic benefits are available to the enterprise in the form of a reduction in future contributions or a cash refund.

Past service costs

- Past service costs are recognised on a straight line basis over the average period until the amended benefits become vested, and should be recognised as an expense immediately to the extent that the benefits are already vested. (This option of deferring recognition of past service costs has received much criticism because it can be argued that a liability exists when part service costs are identified.)

  - Benefits that have because vested, clearly meet the definition of a liability and should accordingly be recognised.

  - Although non-vested benefits give rise to an obligation, any method of attributing non-vested benefits to individual periods is essentially arbitrary. In determining how that obligation builds up, no single method is demonstrably superior to all others.

- Enterprises should recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs.

Other long term employee benefits

These benefits include long service leave, long term disability benefits and deferred compensation benefits.

- Entities that give long service leave and other benefits should estimate their obligation for these benefits at balance date based on the expected 'take-up' of the benefits by these employees (whether these benefits have vested or not). Past history would be used in this regard. In addition, the obligation should be discounted to the balance date.

Termination benefits

- An enterprise should account for termination benefits when the enterprise has a demonstrable obligation to either terminate an employee's employment or to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

- An enterprise is demonstrably committed to a termination when there is a detailed formal plan for the termination and there is no realistic possibility of the enterprise's withdrawal.

- Termination benefits due more than 12 months after balance date should be discounted.

- In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

Equity Compensation Benefits

- The Standard requires certain disclosures about equity compensation benefits. These disclosures are more extensive than our own FRS 30. IAS19 does not specify recognition and measurement requirements.

| Services | Industry Groups | Locations | Contact Us | Search | Hot Topics | Publications | Our Firm | Sponsorship | Global Firm | Careers | Home |