TREASURER'S DIRECTIONS

ACCOUNTING – ASSETS

Section A2.5 : Improvements and Repairs and Maintenance

STATEMENT OF INTENT

Recognition of costs incurred on existing non-current assets as either improvements or expenses can impact the financial performance and financial position of an Agency. This Section explains when costs incurred on existing non-current assets should be capitalised and when they should be treated as expenses.

MAIN FEATURES

Section 38 of the *Financial Management Act* requires every Accountable Officer and every employee of an Agency to comply with the Treasurer's Directions.

Improvements

- Costs incurred on existing non-current assets that enhance the usefulness of an asset in terms of its capacity, quality or remaining useful life are improvements.
- Improvements are to be added to the carrying amount of an existing Agency asset when the improvement:
  - meets the asset recognition and capitalisation criteria; and
  - is part of the Capital Works Program or represents a material amount of the asset (for lower value assets).

Repairs and Maintenance

- Costs incurred on existing non-current assets that maintain the usefulness of an asset are repairs and maintenance expenses.
- Costs incurred on repairs and maintenance of assets are to be expensed in the Operating Statement when incurred.

Major and Periodic Maintenance and Spare Parts

- Major periodic maintenance projects are to be assessed as a whole and in part against the criteria for classification of costs as improvements or repairs and maintenance.
- Major spare parts and stand by equipment are to be recognised as an Agency asset where these items meet the asset recognition and the asset capitalisation criteria.

For authoritative instruction and guidance, reference should be made to related Treasurer's Directions and associated commentary, relevant Australian accounting standards and other authoritative interpretations.

CONTENTS

AUTHORITIES

Financial Management Act

REFERENCES

AAS 29	Financial Reporting by Government Departments
AASB 116	Property, Plant and Equipment
	Capital Construction Principles

Related Treasurer's Directions:

A2.1	Accounting – Assets : Overview
A2.2	Accounting – Assets : Property, Plant and Equipment
A2.3	Accounting – Assets : Depreciation and Amortisation
A2.10	Accounting - Assets : Impairment of Assets
A2.11	Accounting – Assets : Construction (Work in Progress)
A6.1	Accounting – Expenses : Overview
A6.3	Accounting – Expenses : General Expenses

COSTS ON EXISTING NON-CURRENT ASSETS

A2.5.1 **Costs on existing non-current assets are amounts incurred on assets after they have been first put into use or held ready for use.**

(i) Assets are resources controlled by an Agency as a result of past events from which future economic benefits are expected to flow. Asset concepts are explained in the Treasurer's Directions Section A2.1.

(ii) Costs incurred on existing non-current assets may be:

- improvements – that enhance the usefulness of the asset in terms of its capacity, quality or remaining useful life; or
- repairs and maintenance – that preserve the usefulness or functionality of the asset, for example, costs incurred to repair a fault in an item of equipment.

(iii) Funding for repairs and maintenance will be sourced from an Agency's Output Appropriation. Funding for improvements will be sourced from available Agency funds and Capital Appropriation. In some cases, funding for repairs and maintenance and/or improvements may also be sourced from external sources (for example, the Australian Government). The Capital Construction Principles provide instruction and guidance in relation to capital construction.

(iv) Capital costs that meet the asset recognition and capitalisation criteria that do not relate to an existing asset will be recognised as a separate asset in accordance with Treasurer's Directions Section A2.1.

IMPROVEMENTS

A2.5.2 **Costs incurred on an existing non-current Agency asset are to be recognised as improvements when it is probable that additional future economic benefits will flow to the Agency.**

A2.5.3 **Improvements are to be added to the carrying amount of an existing Agency asset when the improvement:**

- **meets the asset recognition and capitalisation criteria; and**
- **is part of the Capital Works Program or represents a material amount of the asset (for lower value assets).**

(i) There is considered to be an increase in the expected future economic benefits arising from a non-current asset if the cost results in:

- an improvement in the service capacity or service quality of the asset;
- an extension of the expected useful life of the asset;
- an addition to the service potential or income earning capacity of the asset; or
- a reduction in the operating costs.

(ii) To reduce administrative effort and associated costs, minor improvements will only be capitalised where the amount incurred is greater than or equal to $10,000. Costs that are less than $10,000 will be expensed when incurred. The term capitalisation refers to expenditure that meets the asset recognition criteria in accordance with Treasurer's Directions Section A2.1 and has a value greater than or equal to $10,000.

(iii) As a general rule, and unless strong evidence exists indicating otherwise, costs associated with Capital Works and Minor New Works projects that are funded through the Capital Works Program will result in an improvement to an existing non-current asset or the recognition of a separately identifiable asset (or assets).

(iv) However, where the improvement is incidental to necessary maintenance work and the increased capacity is not likely to be used in the foreseeable future, it may be appropriate to expense these cost in the Operating Statement. For example, aesthetic or beautification projects in relation to assets not used for service delivery purposes are not likely to improve the asset's future economic benefits unless it results in some measurable and significant quality improvement.

(v) Improvements that satisfy the capitalisation criteria are added to the carrying amount of the existing asset and depreciated over the remaining useful life of the asset. The amount of the improvement will be recognised in the relevant class of non-current assets to which the asset belongs. The depreciation of assets is explained in Treasurer's Directions Section A2.3.

(vi) Some improvement projects, such as ones involving significant construction or development works, may extend beyond one reporting period. Construction and development costs relating to these improvements will be capitalised as construction work in progress as incurred. On completion of the construction works, the value of the improvement will be either added to the carrying amount of an existing non-current asset or recognised as a separately identifiable asset (or assets). Treasurer's Directions Section A2.11 provides instruction and guidance in relation to construction work in progress.

(vii) Certain improvements result in the creation of a separately identifiable asset with a useful life that is different from the remaining useful life of the existing non-current asset. Where significant, such improvements are capitalised as individual assets and depreciated separately. For instance, where an extension for a new library is made to an existing school building, the new extension will be capitalised as a separate asset if it's expected useful life was materially different to the remaining useful life of the existing school building.

(viii) Appendix A provides a flowchart explaining the treatment of costs incurred on existing non-current assets including improvements. Examples of improvements are provided at Appendix B. In addition the Capital Construction Principles provides further instruction and guidance in relation to capital works and improvements.

A2.5.4 **The remaining useful life of an existing non-current asset is to be reassessed where material improvements are made to the asset.**

A2.5.5 **Approval is to be obtained from the Under Treasurer to vary the useful life of an existing non-current asset, where, as a result of an improvement, the remaining useful life will be greater than that provided in Treasurer's Directions Section A2.3, Appendix A.**

(i) The assessment and the reassessment of remaining useful lives of non-current assets will be undertaken by appropriately qualified and experienced persons who are considered experts for the relevant class of non-current assets. Government officers may be used where they have appropriate knowledge and experience.

(ii) Regardless of who undertakes the assessment or reassessment of the remaining useful life of the non-current asset, the basis of the assessment should be clear and properly documented.

(iii) Agencies may recognise an increase in an asset's remaining useful life up to the maximum useful lives specified in Treasurer's Directions Section A2.3, Appendix A.

(iv) Treasurer's Directions Section A2.3 also provides instruction and guidance in relation to the recognition of a material extension in the expected useful life of an asset.

REPAIRS AND MAINTENANCE

A2.5.6 **Costs incurred on existing non-current assets that are not recognised as improvements are to be recognised as repairs and maintenance expenses.**

A2.5.7 **Repairs and maintenance expenses are to be recognised in the Operating Statement in the reporting period in which they are incurred.**

(i) Costs incurred on existing non-current assets that are not recognised as improvements, will be recognised as repairs and maintenance expenses. Treasurer's Directions Sections A6.1 and A6.3 provide instruction and guidance in relation to expenses.

(ii) Repairs and maintenance expenses are incurred to maintain the functionality and/ or the existing service potential of an asset over its useful life. They neither increase nor decrease the carrying amount of an asset and are usually of a regular and on-going nature. Repairs and maintenance expenses include day to day servicing of non-current assets and may include costs in relation to labour, consumables and minor spare parts. Appendix A provides a flowchart explaining the treatment of costs incurred on existing non-current assets including repairs and maintenance. Examples of repairs and maintenance expenses are provided at Appendix B.

(iii) Additionally, minor and immaterial improvements that do not satisfy the capitalisation criteria provided in Treasurer's Directions A2.5.2 and A2.5.3 will also be recognised as repairs and maintenance expenses in the Operating Statement.

(iv) The replacement of spares is differentiated from the replacement of major components. Cost associated with the replacement of spares is recognised as an expense when it does not result in an increase in the expected future economic benefits that will flow from the asset. For example, a part replaced for the purposes of rectifying a fault in an item of equipment is a repairs and maintenance expense.

(v) While Agencies are responsible for maintaining assets under their control, in practice, Agencies will utilise Agency and Government experts in making maintenance decisions. The following should be considered in making decisions relating to maintenance of assets:

- the level of maintenance required to achieve the desired level of performance of the assets over their intended useful lives; and
- maintenance priorities, that is, the identification of higher priority maintenance tasks, such as those that affect health and safety or are operationally critical.

MAJOR PERIODIC MAINTENANCE AND SPARE PARTS

A2.5.8 **Major periodic maintenance projects are to be assessed as a whole and in part against the criteria for classification of costs as improvements or repairs and maintenance.**

(i) Some non-current assets require substantial maintenance costs on major overhauls, refurbishment or refit on a periodic or cyclical basis to enable them to continue to provide services at their intended level. The effect of such major periodic maintenance is that future economic benefits consumed in previous periods may be restored or replaced.

(ii) Major periodic maintenance is usually planned and managed as part of an ongoing cyclical maintenance program and can be differentiated from routine maintenance. Major periodic maintenance costs will be treated as improvements, if they result in an increase in the originally assessed service potential of an asset or replace a separately identifiable asset and amounts are material.

(iii) Certain works projects may involve both capital (improvement) and maintenance costs. In this situation, an evaluation will need to be made of the percentage of the total project cost that is of a capital nature.

(iv) Where the process of apportionment is not straightforward, the cost and administrative effort of undertaking an accurate evaluation may outweigh the associated benefits. In these situations, it may be appropriate to capitalise or expense the total cost depending on the source of the funding (for example, Capital or Output Appropriation). Such decisions are still required to satisfy the asset recognition and capitalisation criteria for improvements and must not result in a material misstatement of an Agency's financial statements. For instance, $130,000 provided through Output Appropriation to repair a building that has a carrying value of $2 million may be expensed even though a small proportion of the works result in building improvements.

(v) The basis of apportioning costs into capital and expense categories should be clear and properly documented.

(vi) The apportionment of costs into capital and expense categories is the responsibility of the relevant Agency and analysis will need to be undertaken by persons having relevant knowledge and experience. Government Officers may be used where they have the required skills and experience.

A2.5.9 Major spare parts and stand-by equipment are to be recognised as an Agency asset where these items meet:

- the asset recognition criteria in Treasurer's Directions A2.1; and
- the asset capitalisation criteria in Treasurer's Directions A2.2.

A2.5.10 An Agency is to derecognise the carrying value of existing major spare parts and asset components that have been replaced when replacement occurs.

(i) Spare parts and servicing equipment are usually carried as inventory and recognised in the Operating Statement as they are consumed. However, major spare parts and stand-by equipment would qualify as an asset if these spare parts meet the asset recognition criteria included in Treasurer's Directions Section A2.1. If the spare parts and stand-by equipment can be used only in connection with an existing Agency asset, then they can be accounted for in the carrying amount of the existing asset and depreciated over the useful life of that asset.

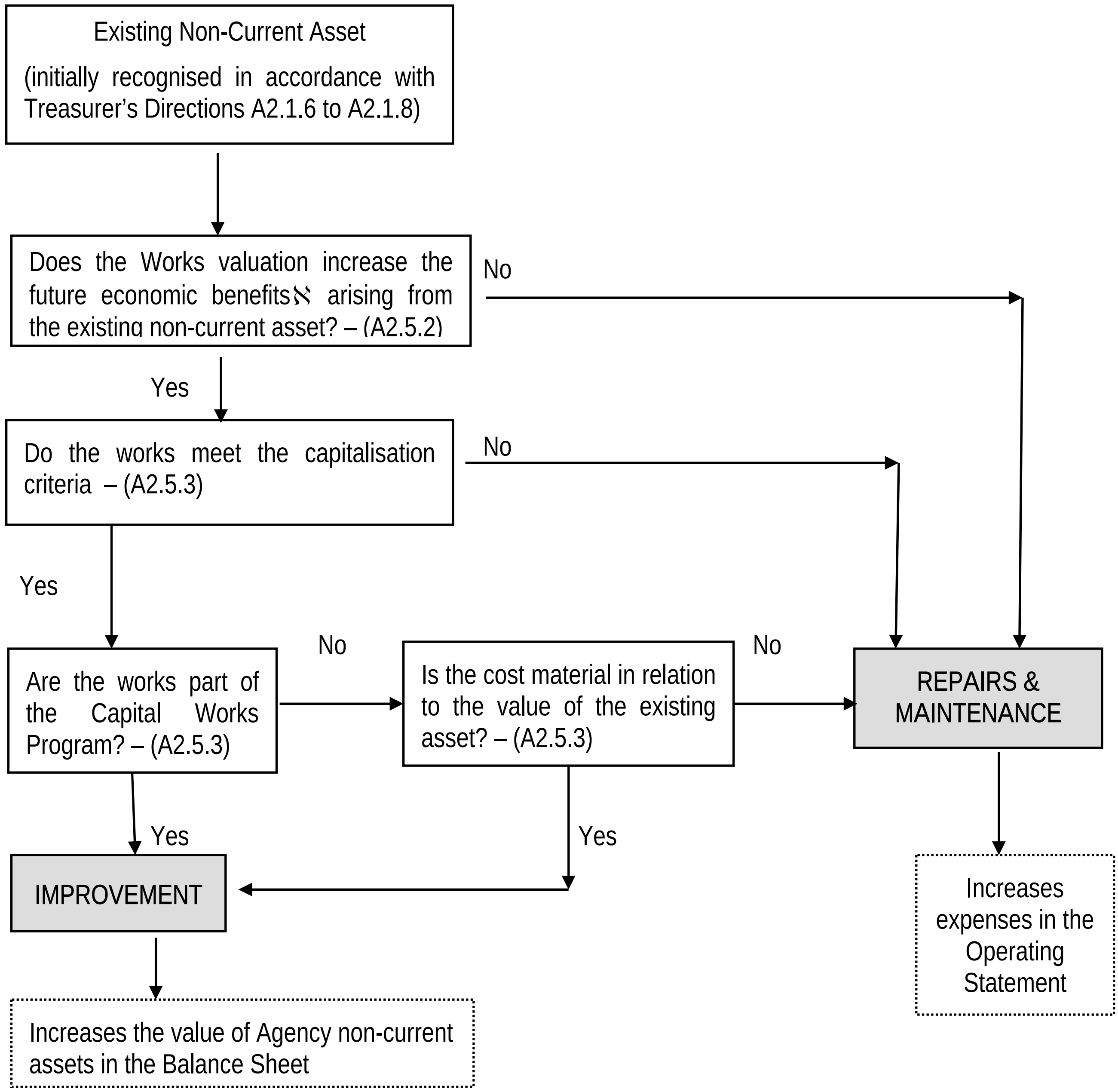
(ii) In addition, some complex non-current assets comprise a number of separately identifiable components that require replacement at regular intervals. This is particularly so for infrastructure assets such as those used in the electricity, water and transport industries. The replacement of such components will be recognised as individual assets and depreciated separately.

(iii) In either case the components of an existing Agency asset that are being replaced are to be derecognised. If it is not practicable for an Agency to determine the carrying amount of the replaced component, it may use the cost of the replacement as an indication of the approximate cost of the replaced part at the time it was acquired or constructed.

APPENDIX A

COSTS ON EXISTING NON-CURRENT ASSETS

The following flowchart has been developed to assist Agencies in accounting for costs incurred in relation to existing non-current assets as improvements or repairs and maintenance. References to individual Treasurer's Directions are included in brackets.



ℵ There is an increase in expected future economic benefits arising from an asset where there is:

- an improvement in its service capacity or service quality;
- an extension of its expected useful life;
- an improvement in its income earning capacity; or

- a reduction in its operating costs.

APPENDIX B

IMPROVEMENTS AND REPAIRS AND MAINTENANCE – EXAMPLES

The following examples are provided as a guide. Agencies should remain aware of the source of funding (Output or Capital) as this will assist in determining the nature of works and improvements or repairs and maintenance. In addition, consideration should be given to other complexities or circumstances surrounding each situation on a case by case basis.

Improvements

1. extension of wharf
2. material extension / widening of roadworks and access improvements
3. bridge upgrade
4. upgrade and modification of existing buildings / facilities / public dwellings (including internal and external work)
5. extension to mains water supply
6. upgrade air-conditioning and lift facilities
7. building extensions resulting in increased storage capacity
8. strengthening a dam wall
9. enhancement to telephone / electrical systems
10. extension to parking area
11. improving street lighting, signage
12. major equipment overhaul and refit

Repairs and Maintenance

1. fixing faults in assets such as lifts, photocopiers and other office equipment
2. repainting of a building
3. electrical and plumbing repairs
4. landscaping within road reserves
5. maintenance of a section of road such as patching potholes or other minor roadworks
6. resealing existing road seal
7. works relating to bushwalking tracks / fire tracks
8. improvements that do not satisfy the capitalisation criteria (for example, improvements less than $10,000)
9. day to day maintenance of equipment