EXPOSURE DRAFT

The Conceptual Framework for General Purpose Financial Reporting by Local Bodies

(Based on corresponding IPSAS's Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities)

(Last date of comments: January 20, 2017)

Issued by

The Committee on Accounting Standards for Local Bodies

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

INVITATION TO COMMENT

The Committee on Accounting Standards for Local Bodies of the Institute of Chartered Accountants of India invites comments on any aspect of this Exposure Draft of the Conceptual Framework for General Purpose Financial Statements along with the below set question. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments can be submitted using any of the following methods, so as to be received not later than January 20, 2017:

1. *Email: Comments can be sent to caslb@icai.in*

2. *Postal: Secretary, Committee on Accounting Standards for Local Bodies, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002.*

Question - The paragraph 7.24 to 7.36 in the Exposure Draft of the Conceptual Framework explains "Market Value" measurement base for the assets. Committee seeks the view of the respondents whether retaining this measurement basis would be relevant for Local Bodies in Indian context or the same may be deleted, if not relevant for Local Bodies in India?

THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY LOCAL BODIES

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Introduction

The Conceptual Framework establishes and makes explicit the concepts that are to be applied in developing Accounting Standards for Local Bodies (ASLBs).

The Conceptual Framework acknowledges that, to respond to users' information needs, GPFRs may include financial statements and information that enhances, complements, and supplements the financial statements. Chapters 1, 2, 3, 4 and 8 deal with concepts that are applicable to all matters that may be encompassed within the scope of GPFRs. Chapters 5, 6 and 7 deal with concepts applicable to the financial statements and do not apply to the more comprehensive areas of financial reporting outside the financial statements.

The Preface to the Conceptual Framework for General Purpose Reporting by Local Bodies

Introduction

1. The *Conceptual Framework for General Purpose Financial Reporting by Local Bodies* (the Conceptual Framework) establishes the concepts that are to be applied in developing Accounting Standards for Local Bodies (ASLBs) that are applicable to the preparation and presentation of general purpose financial reports (GPFRs) of local bodies.

2. The primary objective of local bodies is to deliver services to the public, rather than to make profits and generate a return on equity to investors. Consequently, the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows. GPFRs provide information to users for accountability and decision-making purposes. Therefore, users of the GPFRs of local bodies need information to support assessments of such matters as:
   - Financial position of a local body,
   - Resources controlled by a local body and restriction and conditions attached to their use,
   - Overall Financial solvency of a local body,
   - Whether the entity provided its services to constituents in an efficient and effective manner; and
   - Ability of a local body to continue to provide efficient and effective services.

3 The 73rd and 74th Constitutional Amendment Acts envisage a key role for the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing and drinking water etc. The State Governments are required to devolve powers and responsibilities upon the PRIs and the ULBs with respect to preparation of plans for economic development and social justice, and for the implementation of development schemes as may be required to enable them to function as institutions of self-government. Due to such devolution of powers and responsibilities, the role of the PRIs and ULBs varies across various States.

Article 243G and 243W of the 73rd and 74th Constitutional Amendment Acts respectively deals with Powers, authority and responsibilities of Panchayat and Municipalities etc., subject to the provisions of this Constitution, the Legislature of a State may, by law, endow-

(a) the Panchayat and Municipalities etc. with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon Municipalities, subject to such conditions as may be specified therein, with respect to-

(i) the preparation of plans for economic development and social justice;

(ii) the performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Eleventh and Twelfth Schedule respectively for Panchayat and Municipalities;

(b) the Committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule.

3.A Powers to impose taxes by, and Funds of, the Local Bodies:

Article 243H and 243X of the 73rd and 74th Constitutional Amendment Acts respectively of the Constitution states that the legislature of a State may, by law-

• Authorize a Panchayat / Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits;

• assign to a Panchayat / Municipality such taxes, duties, tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits;

• provide for making such grants-in-aid to the Panchayats/ Municipality from the Consolidated Fund of the State; and

• provide for Constitution of such Funds for crediting all moneys received, respectively, by or on behalf of the Panchayats/ Municipality and also for the withdrawal of such moneys.

3.B Accounting Reforms as Engines of Good Governance

An integral part of the new expectations of governance is for Public Information – without which there cannot be meaningful participation or shared decision-making. The public expects a fair account of how the government is faring in its job.

It is necessary that accounting system has to satisfy the following basic objectives (i) be accurate in capturing the underlying transactions, (ii) enhance transparency, and (iii) be user-friendly to facilitate understanding of the accounting statements by most users. The prevailing single entry / cash-based accounting system in India is deficient on the dimensions of transparency and user-friendliness and therefore it becomes necessary to reform the accounting system.

The Supreme Court of India in the year 2001, while hearing a Public Interest Litigation (PIL) relating to the functioning of ULBs, opined that urban local bodies in India should take immediate steps to get their accounts converted from cash basis to accrual basis.

The Accrual System of accounting is an improvement over the present single entry / cash system of accounting and not a mere replacement of the existing system. While cash accounts serve the purpose of legislative control over public finances, an accrual system is helpful in expanding the efficacy of fiscal management. The appropriate accounting system provides all the information that is available in the present dispensation, besides providing such additional information which will make the accounting records more complete from a users' perspective.

Further Article 243J and Article 243Z of the 73rd and 74th Constitutional Amendment Acts respectively of the Constitution states that the Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Panchayats and the auditing of such accounts.

3.C The term 'Local Body' may be defined as a local self-government at the third tier of governance in an administrative and geographical vicinity, e.g., a municipal corporation, a municipality or a panchayat. In many cases, the Local Bodies delegate their functions such as building of schools, city roads, parks, running transport services, providing water supply etc., to some other bodies that may or may not be controlled by the Local Bodies, e.g. development authorities, boards, parastatals etc. Such bodies may be constituted, in partnership with private sector or otherwise, directly or indirectly by or on behalf of a Local Body to promote or carry out some specific objective(s) or function(s) of the Local Bodies. Such entities may be constituted under a statute. The term 'Local Body' would also encompass all such entities.

4. The following sections highlight peculiar characteristics of the local body that the CASLB has considered in the development of the Conceptual Framework.

The Volume and Financial Significance of Non-Exchange Transactions

5. In a non-exchange transaction, an entity either receives/ give value from/to another party without directly giving/ receiving any value in exchange, such transactions are common in the local body. The level and quality of services received by an individual, or group of individuals, is not normally directly related to the level of taxes assessed as they have to pay a charge or fee and/or may make specified contributions to access certain services. However, such transactions are, generally, of a non-exchange nature, because the amount that an individual or group of individuals obtains in benefits will not be equal to the amount of any fees paid or contributions made by the individual or group. The nature of non-exchange transactions may have an impact on how they are recognised, measured, presented and disclosed to best support assessments of the entity by service recipients and resource providers.

6. Taxation is a legally mandated, compulsory non-exchange transaction between individuals or entities and the local-self-government. Tax-raising powers can vary considerably, dependent upon the relationship between the powers of the state government and those of local self-governments. Local Bodies are accountable to resource providers, particularly to those that provide resources through taxes and other compulsory transactions.

7. Local Bodies are accountable to resource providers, particularly to those that provide resources through taxes and other compulsory transactions. The accountability objective of financial reporting Chapter 2, *Objectives and Users of General Purpose Financial Reporting,* discusses the accountability objective of financial reporting.

The Importance of the Approved Budget

8. Mostly local bodies prepare budgets and make them publicly available as per the requirement of the relevant legislature (or equivalent). Legislation, i.e., relevant act/ law often defines the contents of that documentation. The governing body, i.e., the elected representatives exercises oversight, and hold the entity's management financially accountable through the budget and other mechanisms. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining governing body's approval for spending.

9. Because of the approved budget's significance, information that enables users to compare financial results with the budget facilitates an assessment of the extent to which an entity has met its financial objectives. Such information promotes accountability and informs decision making in subsequent budgets. Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the public finances. The needs of users for budget information is discussed in Chapter 2.

The Nature of Local Body Programs and interpretation of Going Concern principle.

10. Many local body programs are long term and the ability to meet commitments depends upon future taxation and contribution. Many commitments arising from local body programs and powers to levy future taxation do not meet the definitions of a liability and an asset which is discussed in Chapter 5, *Elements in Financial Statements*. Therefore, such commitments and powers are not recognised in the financial statements.

11. Consequently, the balance sheet and income and expenditure statement cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity's finances and key programs are necessary for accountability and decision-making purposes as discussed in Chapter 2.

12. Many times, due to changes in political control the Local Bodies may encounter severe financial difficulties, and may default on sovereign debt obligations, still local bodies continue to exist. If local bodies get into financial difficulties, other level of governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of entities may continue to be funded by a higher level of government. In other cases, entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

13. The going concern principle underlie the preparation of the financial statements. Interpretation of the principle needs to reflect the issues discussed in paragraphs 11 and 12.

The Nature and Purpose of Assets and Liabilities in the Local Body

14. In the local body, the primary reason for holding property, plant and equipment and other assets acquired, owned, developed or controlled or maintained by entity are either for

(a) its own use for their service potential that enables the local bodies to achieve their service delivery objectives with or without generating future economic benefits.
(b) use of public at certain fee or charges / concession etc.
(c) to preserve historical, heritage and other art effects and
(d) use of general public without any restriction and covenants but these may be maintained by local bodies to perform the functions as may be entrusted to them. Such assets are created for public use that are never intended to generate any cash flow, and a significant proportion of expenditure is incurred by local bodies on such assets like on roads, drainage, sewage, sewage plant, parks, street light, water treatment plant and alike.

15. Local Bodies may hold items that contribute to the historical and cultural character - for example, art treasures, historical buildings, and other artifacts. They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, entities have a responsibility to preserve and maintain them for current and future generations.

16. Local bodies may have powers over natural and other resources such as mineral reserves, water, fishing grounds, and forests. These powers allow them to grant licenses for the use of such resources or to obtain royalties and taxes from their use.

The definition of an asset, recognition criteria and measurement bases for assets are discussed in Chapters 5, 6 & 7.

17. Local Bodies incur liabilities related to their service delivery objectives. Many liabilities arise from non-exchange transactions and include those related to programs that operate to deliver social benefits. Liabilities may also arise from any obligations to transfer resources to those affected by disasters. The definition of a liability and recognition criteria are discussed in Chapters 5 and 6.

The Regulatory Role of Local Bodies

18. Local Bodies have powers to regulate in many cases entities operating in certain sectors of the economy, either directly or through specifically created agencies. In addition to this Local Bodies have powers to regulate granting permission for land use and approval of construction activity/ building plan etc. The underlying public policy rationale for regulation is to safeguard the public interest in accordance with specified public policy objectives. Such regulatory activities are carried out in accordance with legal processes.

19. Local bodies may also regulate themselves and other entities controlled by them. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, entities that require recognition as assets and liabilities, or whether amendment of such regulations has an impact on how such rights and obligations are accounted for. Chapter 5 considers rights and obligations.

20-24. [Deleted]

CHAPTER 1: ROLE AND AUTHORITY OF THE CONCEPTUAL FRAMEWORK

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Chapter 1: Role and Authority of the Conceptual Framework

Role of the Conceptual Framework

1.1 The *Conceptual Framework for General Purpose Financial Reporting by Local Bodies* (the Conceptual Framework) establishes the concepts that underlie general purpose financial reporting (financial reporting) by local bodies that adopt the accrual basis of accounting. The Committee on Accounting Standards for Local Bodies (CASLB) will apply these concepts in developing Accounting Standards for Local Bodies (ASLBs) that are applicable to the preparation and presentation of general purpose financial reports (GPFRs) of local bodies.

Authority of the Conceptual Framework

1.2 The Conceptual Framework does not establish authoritative requirements for financial reporting by local bodies that apply ASLBs, nor does it override the requirements of ASLBs. Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities that are reported in GPFRs are specified in ASLBs.

1.3 The Conceptual Framework can provide guidance in dealing with financial reporting issues not dealt with by ASLBs. In these circumstances, preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts covered in the Conceptual Framework.

General Purpose Financial Reports

1.4 GPFRs are a central component of, and support and enhance, transparent financial reporting by local bodies. GPFRs are financial reports intended to meet the information needs of user.

1.5 Some users of financial information may have the authority to require the preparation of reports tailored to meet their specific information needs. While such parties may find, the information provided by GPFRs useful for their purposes, GPFRs are not developed to specifically respond to their particular information needs.

1.6 GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters. GPFRs encompass financial statements including their notes (hereafter referred to as financial statements, unless specified otherwise), and the presentation of additional information by the entity that enhances, complements and supplements the financial statements which is useful for the users for accountability, decision making purposes and for assessment of future service delivery capacity.

1.7 The scope of financial reporting establishes the boundary around the transactions, other events and activities that may be reported in GPFRs. The scope of financial reporting is determined by the information needs of the primary users of GPFRs and the objectives of financial reporting. The factors that determine what may be encompassed within the scope of financial reporting are outlined in the next chapter.

Applicability of the Conceptual Framework

1.8 The Conceptual Framework, applies to financial reporting by entities described as local bodies in the 'Preface to the Accounting Standards for Local Bodies' that apply ASLBs.

CHAPTER 2: OBJECTIVES AND USERS OF GENERAL PURPOSE FINANCIAL REPORTING

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Chapter 2: Objectives and Users of General Purpose Financial Reporting

Objectives of Financial Reporting

2.1 The objectives of financial reporting by local bodies are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes (hereafter referred to as "useful for accountability and decision-making purposes").

2.2 The objectives of financial reporting are determined by reference to the users of GPFRs, and their information needs.

Users of General Purpose Financial Reports

2.3 Local Bodies raise resources from taxpayers, grantors, lenders and other resource providers for use in the provision of services to citizens and other service recipients. These entities are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services. Those that provide the resources and receive, or expect to receive, the services also require information as input for decision-making purposes.

2.4 Consequently, GPFRs of local bodies are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require a local body to disclose the information they need for accountability and decision-making purposes. The governing body, i.e., the elected representatives are also primary users of GPFRs, and make extensive and ongoing use of GPFRs when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of the Conceptual Framework, the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives (hereafter referred to as "service recipients and resource providers", unless identified otherwise).

2.5 Citizens receive services from, and provide resources to, the local bodies. Therefore, citizens are primary users of GPFRs. Some service recipients and some resource providers that rely on GPFRs for the information they need for accountability and decision-making purposes may not be citizens—for example, residents who pay taxes and/or receive benefits but are not citizens; multilateral or bilateral external assistance/ grantor agencies and many lenders that provide resources to, and transact with, a local body.

2.6 GPFRs prepared to respond to the information needs of service recipients and resource providers for accountability and decision-making purposes may also provide information useful to other parties and for other purposes. For example, statisticians, analysts, the media, financial advisors, public interest and advocacy groups and others may find the information provided by GPFRs useful for their own purposes Organisations / Bodies that have the authority to require the preparation of financial reports tailored to meet their own specific information needs may also use the information provided by GPFRs for their own purposes—for example, regulatory and oversight bodies, local body audit departments, sub-committees of the governing body, and, in some cases, lending institutions and providers of development and other assistance. While these other parties may find the information provided by GPFRs useful, they are not the primary users of GPFRs. Therefore, GPFRs are not developed to specifically respond to their particular information needs.

Accountability and Decision Making

2.7 The primary function of local bodies are to provide services that enhance or maintain the well-being of citizens and other eligible residents. Those services include, for example, welfare programs and policing, public education, health and transportation services. In most cases, these services are provided as a result of a non-exchange transaction[1] and in a non-competitive environment.

2.8 Local Bodies are accountable to resource providers, and dependent users during the reporting period and over the longer term which requires the provision of information about the entity's management of the resources entrusted to it and its compliance with legislation, regulation, or other authority that governs its service delivery and other operations.

2.9 Service recipients and resource providers will also require information as input for making decisions. For example:

- Lenders, creditors, grantors and others that provide resources on a voluntary basis, including in an exchange transaction, make decisions about whether to provide resources to support the current and future activities of the local body. In some circumstances, members of the governing body who depend on GPFRs for the information they need, can make or influence decisions about the service delivery objectives of the entity, its departments, agencies or programs and the resources allocated to support their achievement; and

- Taxpayers do not usually provide funds to the local body on a voluntary basis or as a result of an exchange transaction. In addition, in many cases, they do not have the discretion to choose whether or not to accept the services provided by a local body or to choose an alternative service provider. Consequently, they have little direct or immediate capacity to make decisions about whether to provide resources to the local body, the resources to be allocated for the provision of services by a particular entity or whether to purchase or consume the services provided. However, service recipients and resource providers can make decisions about their voting preferences, and representations they make to elected representatives—these decisions may have resource allocation consequences for certain local bodies.

2.10 Information provided in GPFRs for accountability purposes will contribute to, and inform, decision making. For example, information about the costs, efficiency and effectiveness of past service delivery activities, the amount and sources of cost recovery, and the resources available to support future activities will be necessary for the discharge of accountability. This information will also be useful for decision making by users of GPFRs, including decisions that grantors and other financial supporters make about providing resources to the entity.

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1 Exchange transactions are transactions in which the entity transfers goods or services, or use of assets, and receives some value (primarily in the form of cash, goods, services or has liabilities extinguished) from another entity in exchange. Non-exchange transactions are transactions in which an entity receives value from another entity without directly giving any value in exchange or gives value to the another entity without receiving any value in exchange.

Information Needs of Service Recipients and Resource Providers

2.11 For accountability and decision-making purposes, service recipients and resource providers will need information about the performance, liquidity, solvency, sustainability and capacity of the entity that supports the assessments of such entity.

2.12 The information service recipients and resource providers need for these purposes is likely to overlap in many respects. For example, service recipients will require information as input to assessments of such matters as whether:

- The entity is using resources economically, efficiently, effectively and as intended, and whether such use is in their interest;
- The range, volume and cost of services provided during the reporting period are appropriate, and the amounts and sources of their cost recoveries; and
- Current levels of taxes or other resources raised are sufficient to maintain the volume and quality of services currently provided. Service recipients will also require information about the consequences of decisions made, and activities undertaken, by the entity during the reporting period on the resources available to support the provision of services in future periods, the entity's anticipated future service delivery activities and objectives, and the amounts and sources of cost recoveries necessary to support those activities.

2.13 Resource providers will require information as input to assessments of such matters as whether the entity:

- Is achieving the objectives established as the justification for the resources raised during the reporting period;
- Funded current operations from funds raised in the current period from taxpayers or from borrowings or other sources; and
- Is likely to need additional (or less) resources in the future, and the likely sources of those resources.

While lenders and creditors will require information as input to assessments of the liquidity, repayment capability; grantors will require information about economical, efficient and effective use of resources as intended.

Information Provided by General Purpose Financial Reports

Financial Position, Financial Performance, and Cash Flows

2.14 Information about financial position, financial performance and cash flows are typically presented in financial statements. Information about the financial position of a local body will enable users to identify the resources of the entity and claims to those resources at the reporting date. This will provide information useful as input to assessments of such matters as:

- The extent to which management has discharged its responsibilities for safekeeping and managing the resources of the entity;
- The extent to which resources are available to support future service delivery activities, and changes during the reporting period in the amount and composition of those resources and claims to those resources; and

- The amounts and timing of future cash flows necessary to service and repay existing claims to the entity's resources.

2.15 Information about the financial performance of a local body will inform assessments of matters such as whether the entity has acquired resources economically, and used them efficiently and effectively to achieve its service delivery objectives.

2.16 Information about the cash flows of a local body contributes to assessments of financial performance and the entity's liquidity and solvency. It indicates how the entity raised and used cash during the period, from operating, financing and investing activities.

2.17 To assist users to better understand, interpret and place in context the information presented in the financial statements, GPFRs may also provide financial and non-financial information that enhances, complements and supplements the financial statements, including information about such matters as the local body's:

- Compliance with approved budgets and other authority governing its operations;
- Service delivery activities and achievements during the reporting period; and
- Expectations regarding service delivery and other activities in future periods, and the long-term consequences of decisions made and activities undertaken during the reporting period, including those that may impact expectations about the future.

This information may be presented in the notes to the financial statements or in separate reports included in GPFRs.

Budget Information and Compliance with Legislation or Other Authority Governing the Raising and Use of Resources

2.18 Typically, a governing body of the local body approves and makes publicly available an annual budget. The approved budget provides interested parties with financial information about the entity's operational plans for the forthcoming period, its capital needs and, often, its service delivery objectives and expectations. It is used to justify the raising of resources from taxpayers and other resource providers, and establishes the authority for expenditure of resources.

2.19 Some resources to support the activities of local bodies may be received from grantors, lenders or as a result of exchange transactions. However, resources to support the activities of local bodies are predominantly provided in non-exchange transactions by taxpayers and others.

2.20 GPFRs provide information about the financial results (described as “surplus or deficit”), performance and cash flows of the entity during the reporting period, its assets and liabilities at the reporting date and the change therein during the reporting period, and its service delivery achievements.

2.21 The inclusion within GPFRs of information that assists users in assessing the extent to which revenues, expenses, cash flows and financial results of the entity comply with the estimates reflected in approved budgets, and the entity’s adherence to relevant legislation or other authority governing the raising and use of resources, is important in determining how well a local body has met its financial objectives.

Service Delivery Achievements

2.22 The primary objective of local bodies are to provide needed services to constituents. Consequently, the financial performance of local bodies will not be fully or adequately reflected in any measure of financial results. Therefore, their financial results will need to be assessed in the context of the achievement of service delivery objectives.

2.23 In some cases, quantitative measures of the outputs and outcomes of the entity’s service delivery activities during the reporting period will provide relevant information about the achievement of service delivery objectives—for example, information about the cost, volume, and frequency of service delivery, and the relationship of services provided to the resource base of the entity.

2.24 Reporting non-financial as well as financial information about service delivery activities, achievements and/or outcomes during the reporting period will provide input to assessments of the economy, efficiency, and effectiveness of the entity’s operations. Reporting such information is necessary for a local body to discharge its obligation to be accountable—that is, to account for, and justify the use of, the resources raised from, or on behalf of, constituents and for future allocation of resources.

Prospective Financial and Non-financial Information

2.25 Given the longevity of local body programs, the financial consequences of many decisions made in the reporting period may only become clear many years into the future. Financial statements which present information about financial position at a point in time and financial performance and cash flows over the reporting period will then need to be assessed in the context of the long term.

2.26 Decisions made by a local body in a particular period about programs for delivering and funding services in the future can have significant consequences for:

- Constituents who will be dependent on those services in the future; and
- Current and future generations of taxpayers and other involuntary resource providers who will provide the taxes and levies to fund the planned service delivery activities and related financial commitments.

2.27 Information about the entity's anticipated future service delivery activities and objectives, their likely impact on the future resource needs of the entity and the likely sources of funding for such resources, will be necessary as input to any assessment of the ability of the local body to meet its service delivery and financial commitments in the future.

Explanatory Information

2.28 Information about the major factors underlying the financial and service delivery performance of the entity during the reporting period and the assumptions that underlie expectations about, and factors that are likely to influence, the entity's future performance may be presented in GPFRs in notes to the financial statements or in separate reports. Such information will assist users to better understand and place in context the financial and non-financial information included in GPFRs, and enhance the role of GPFRs in providing information useful for accountability and decision-making purposes.

Financial Statements and Information that Enhances, Complements and Supplements the Financial Statements

2.29 The scope of financial reporting establishes the boundary around the transactions, other events and activities that may be reported in GPFRs. To respond to the information needs of users, the Conceptual Framework reflects a scope for financial reporting that is more comprehensive than that encompassed by financial statements. It provides for the presentation within GPFRs of additional information that enhances, complements, and supplements those statements.

2.30 While the Conceptual Framework reflects a scope of financial reporting that is more comprehensive than that encompassed by financial statements, information presented in financial statements remains at the core of financial reporting. How the elements of financial statements are defined, recognised and measured, and forms of presentation and communication that might be adopted for information included within GPFRs, is considered in other chapters of the Conceptual Framework and in the development of individual ASLBs, as appropriate.

Other Sources of Information

2.31 GPFRs play a significant role in communicating information necessary to support the discharge of a local body's obligation to be accountable, as well as providing information useful as input for decision-making purposes. However, it is unlikely that GPFRs will provide all the information users need for accountability and decision-making purposes. For example, while comparison of actual with budget information for the reporting period may be included in GPFRs, the budgets and financial forecasts issued by local bodies provide more detailed financial and non-financial information about the financial characteristics of the plans of local bodies over the short and medium terms. Local Bodies and their agencies also issue reports on the need for, and sustainability of, existing service delivery initiatives and anticipated economic conditions and changes in the jurisdiction's demographics over the medium and longer term that will influence budgets and service delivery needs in the future. Consequently, service recipients and resource providers may also need to consider information from other sources, including reports on current and anticipated economic conditions, local body budgets and forecasts, and information about local body policy initiatives not reported in GPFRs.

CHAPTER 3: QUALITATIVE CHARACTERISTICS

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Chapter 3: Qualitative Characteristics

Introduction

3.1 GPFRs present financial and non-financial information about economic and other events. The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. The objectives of financial reporting are to provide information useful for accountability and decision-making purposes.

3.2 The qualitative characteristics of information included in GPFRs of local bodies are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.

3.3 Pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.

3.4 Each of the qualitative characteristics is integral to, and works with, the other characteristics to provide in GPFRs information useful for achieving the objectives of financial reporting. However, in practice, all qualitative characteristics may not be fully achieved, and a balance or trade-off between certain of them may be necessary.

3.5 The qualitative characteristics apply to all financial and non-financial information reported in GPFRs, including historic and prospective information, and explanatory information. However, the extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information.

Relevance

3.6 Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.

3.7 Financial and non-financial information has confirmatory value if it confirms or changes past (or present) expectations. For example, information will be relevant for accountability and decision-making purposes if it confirms expectations about such matters as the extent to which managers have discharged their responsibilities for the efficient and effective use of resources, and compliance with relevant budgetary, legislative and other requirements.

3.8 GPFRs may present information about an entity's anticipated future service delivery activities, objectives and costs, and the amount and sources of the resources that are intended to be allocated to providi~~ing~~ services in the future. Such future oriented information will have predictive value and be relevant for accountability and decision-making purposes. Information about economic and other events that exist or have already occurred can also have predictive value which helps to form expectations about the future.

3.9 The confirmatory and predictive roles of information are interrelated—for example, information about the current level and structure of an entity's resources and claims to those resources helps users to confirm the outcome of resource management strategies during the period, and to predict an entity's ability to respond to changing circumstances and anticipated future service delivery needs.

Faithful Representation

3.10 To be useful in financial reporting, information must be a faithful representation of the economic and other events. Faithful representation is attained when the depiction of the event is complete, neutral, and free from material error. Information that faithfully represents an economic or other event depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.

3.11 Pervasive efforts should be made so that the information presented in GPFRs is complete, neutral, and free from error.

3.12 An omission of some information can cause the representation of an economic or other event to be false or misleading, and thus not useful to users of GPFRs. For example, a complete depiction of the item "plant and equipment" in GPFRs will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory information necessary to faithfully represent that class of assets. In some cases, this may include the disclosure of information about such matters as the major classes of plant and equipment, factors that have affected their use in the past or might impact on their use in the future, and the basis and process for determining their numeric representation.

3.13 Neutrality in financial reporting is the absence of bias which requires reporting without any intention of attaining a particular predetermined result—for example, to influence in a particular way users' assessment of the discharge of accountability by the entity or a decision or judgment that is to be made, or to induce particular behavior.

3.14 Neutral information faithfully represents the economic and other events that it intents ~~purports~~ to represent. However, to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behavior.

3.15 The economic and other events represented in GPFRs generally occur under conditions of uncertainty and often include estimates that are generally based on the management's judgment which shall be supported by appropriate input and best available information. It may sometimes be necessary to explicitly disclose the degree of uncertainty in financial and non-financial information to faithfully represent economic and other events.

3.16 Free from material error does not mean complete accuracy in all respects. Free from material errors means there are no errors or omissions that are individually or collectively material in the description of the event and the process used to produce the reported information has been applied as described. In some cases, it may be possible to determine the accuracy of some information included in GPFRs—for example, the amount of a cash transfer to another level of government, the volume of services delivered or the price paid for the acquisition of plant and equipment. However, in other cases it may not—for example, the accuracy of an estimate of the value or cost of an item or the effectiveness of a service delivery program may not be able to be determined. In these cases, the estimate will be free from material error if the amount is clearly described as an estimate, the nature and limitations of the estimation process are explained, and no material errors have been identified in selecting and applying an appropriate process for developing the estimate.

Understandability

3.17 Understandability is the quality of information that enables users to comprehend its meaning. GPFRs of local bodies should present information in a classified, concise, comparable and in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. For example, explanations of financial and non-financial information and commentary on service delivery and other achievements during the reporting period and expectations for future periods should be written in plain language, and presented in a manner that is readily understandable by users.

3.18 Users of GPFRs are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, to be able and prepared to read GPFRs, and to review and analyse the information presented with reasonable diligence. All efforts should be undertaken to represent economic and other events included in GPFRs in a manner that is understandable to a wide range of users. However, information should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance.

Timeliness

3.19 Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Availability of information timely can enhance its usefulness as input to assessments of accountability and its capacity to inform and influence decisions that need to be made. A lack of timeliness can render information less useful.

3.20 Some items of information may continue to be useful long after the reporting period or reporting date. For example, for accountability and decision-making purposes, users of GPFRs may need to assess trends in the financial and service delivery performance of the entity and its compliance with budgets over a number of reporting periods.

Comparability

3.21 Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of events. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.

3.22 Comparability differs from consistency. Consistency refers to the use of the same accounting principles or policies and basis of preparation, either from period to period within an entity or in a single period across more than one entity. Comparability is the goal, and consistency helps in achieving that goal. In some cases, the accounting principles or policies adopted by an entity may be revised to better represent a particular transaction or event in GPFRs. In these cases, the inclusion of additional disclosures or explanation may be necessary to satisfy the characteristics of comparability.

3.23 Comparability also differs from uniformity. For information to be comparable, like things must look alike and different things must look different. An over-emphasis on uniformity may reduce comparability by making unlike things look alike. Comparability of information in GPFRs is not enhanced by making unlike things look alike, any more than it is by making like things look different.

3.24 Information about the entity's financial position, financial performance, cash flows, compliance with approved budgets and relevant legislation or other authority governing the raising and use of resources, service delivery achievements, and its future plans is necessary for accountability purposes and useful as input for decision-making purposes.

3.25 Consistent application of accounting principles, policies and basis of preparation to prospective financial and non-financial information and actual outcomes will enhance the usefulness of any comparison of projected and actual results. Comparability with other entities may be less significant for explanations of management's perception or opinion of the factors underlying the entity's current performance.

Verifiability

3.26 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other events that it purports to represent. Supportability is sometimes used to describe this quality when applied in respect of explanatory information and prospective financial and non-financial quantitative information disclosed in GPFRs—that is, the quality of information that helps assure users that explanatory or prospective financial and nonfinancial quantitative information faithfully represents the economic and other events that it purports to represent. Whether referred to as verifiability or supportability, the characteristic implies that different knowledgeable and independent observers could reach general consensus, although not necessarily complete agreement, that either:

- The information represents the economic and other events that it purports to represent without material error or bias; or
- An appropriate recognition, measurement, or representation method has been applied without material error or bias.

3.27 To be verifiable, information need not be a single point estimate. A range of possible amounts and the related probabilities also can be verified.

3.28 Verification may be direct or indirect. With direct verification, an amount or other representation is itself verified, such as by (a) counting cash, (b) observing marketable securities and their prices, or (c) confirming that the factors identified as influencing past service delivery performance were present and operated with the effect identified. With indirect verification, the amount or other representation is verified by checking the inputs and recalculating the outputs using the same accounting convention or methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, average cost or first-in-first-out).

3.29 The quality of verifiability (or supportability if such term is used to describe this characteristic) is not an absolute—some information may be more or less capable of verification than other information. However, the more verifiable is the information included in GPFRs, the more it will assure users that the information faithfully represents the economic and other events that it purports to represent.

3.30 GPFRs of local bodies may include financial and other quantitative information and explanations about (a) key influences on the entity's performance during the period, (b) the anticipated future effects or outcomes of service delivery programs undertaken during the reporting period, and (c) prospective financial and non-financial information. It may not be possible to verify the accuracy of all quantitative representations and explanations of such information until a future period, if at all.

3.31 To help assure users that prospective financial and non-financial quantitative information and explanations included in GPFRs faithfully represents the economic and other events that they purport to represent, the assumptions that underlie the information disclosed, the methodologies adopted in compiling that information, and the factors and circumstances that support any opinions expressed or disclosures made should be transparent. This will enable users to form judgments about the appropriateness of those assumptions and the method of compilation, measurement, representation and interpretation of the information.

Constraints on Information Included in General Purpose Financial Reports

Materiality

3.32 Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.

3.33 Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them.

3.34 Materiality is classified as a constraint on information included in GPFRs in this Conceptual Framework. In developing ASLBs, the CASLB will consider the materiality of the consequences of application of a particular accounting policy, basis of preparation or disclosure of a particular item or type of information. Subject to the requirements of any ASLB, entities preparing GPFRs will also consider the materiality of, for example, the application of a particular accounting policy and the separate disclosure of particular items of information.

Cost-Benefit

3.35 Financial reporting imposes costs. The benefits of financial reporting should justify those costs. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment, because it is often not possible to identify and/or quantify all the costs and all the benefits of information included in GPFRs.

3.36 The costs of providing information include the costs of collecting and processing the information, the costs of verifying it and/or presenting the assumptions and methodologies that support it, and the costs of disseminating it. Users incur the costs of analysis and interpretation. Omission of useful information also imposes costs, including the costs that users incur to obtain needed information from other sources and the costs that result from making decisions using incomplete data provided by GPFRs.

3.37 Preparers expend the majority of the effort to provide information in GPFRs. However, service recipients and resource providers ultimately bear the cost of those efforts—because resources are redirected from service delivery activities to preparation of information for inclusion in GPFRs.

3.38 Information provided by GPFRs are not only used by Users but also used internally by management for better decision making. The disclosure of information in GPFRs consistent with the concepts identified in the Conceptual Framework and ASLBs will enhance and reinforce perceptions of the transparency of financial reporting by local bodies.

3.39 Application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information. When making this assessment, it is necessary to consider whether one or more qualitative characteristic might be sacrificed to some degree to reduce cost.

3.40 [Deleted]

Balance between the Qualitative Characteristics

3.41 The qualitative characteristics work together to contribute to the usefulness of information. For example, neither a depiction that faithfully represents an irrelevant event, nor a depiction that unfaithfully represents a relevant event, results in useful information. Similarly, to be relevant, information must be timely and understandable.

3.42 In some cases, a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting. The relative importance of the qualitative characteristics in each situation is a matter of professional judgment. The aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial reporting.

CHAPTER 4: REPORTING ENTITY

CONTENTS

Chapter 4: Reporting Entity

Introduction

4.1 A reporting entity is a local body, its program or identifiable area of activity (hereafter referred to as an entity or local body) that prepares GPFRs.

4.2 A reporting entity may comprise two or more separate entities that present GPFRs as if they are a single entity—such a reporting entity is referred to as a group reporting entity.

Key Characteristics of a Reporting Entity

4.3 Key characteristics of a reporting entity are that:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

4.4 A local body may operate through or delegate its functions to some other bodies such as development authorities, boards, societies, parastatals, etc. Such bodies may be constituted, in partnership with private sector or otherwise, directly or indirectly by or on behalf of a Local Body to promote or carry out some specific objective(s) or function(s) of the Local Bodies. Such entities may be constituted under a statute. Such entities, may also undertake certain activities through, and may benefit from and be exposed to a financial burden or loss as a result of, the activities of entities with a separate legal identity or operational autonomy.

4.5 GPFRs are prepared to report information useful to users for accountability and decision-making purposes. Service recipients and resource providers are the primary users of GPFRs. Consequently, a key characteristic of a reporting entity, including a group reporting entity, is the existence of service recipients or resource providers who are dependent on GPFRs of that entity or group of entities for information for accountability or decision-making purposes.

4.6 GPFRs encompass financial statements and information that enhances, complements and supplements the financial statements. Financial statements present information about the resources of the reporting entity or group reporting entity and claims to those resources at the reporting date, and changes to those resources and claims and cash flows during the reporting period. Therefore, to enable the preparation of financial statements, a reporting entity will raise resources and/or use resources previously raised to undertake activities for the benefit of, or on behalf of, its constituents.

4.7 The factors that are likely to signal the existence of users of GPFRs of an entity or group of entities include an entity having the responsibility or capacity to raise or deploy resources, acquire or manage public assets, incur liabilities, or undertake activities to achieve service delivery objectives. The greater the resources that an entity raises, manages and/or has the capacity to deploy, the greater the liabilities it incurs and the greater the economic or social impact of its activities, the more likely it is that there will exist service recipients or resource providers who are dependent on GPFRs for information about it for accountability and decision-making purposes. In the absence of these factors, or where they are not significant, it is unlikely that users of GPFRs of these entities will exist.

4.8 The preparation of GPFRs is not a cost-free process. Therefore, if the imposition of financial reporting requirements is to be efficient and effective, it is important that only those entities for which such users exist are required to prepare GPFRs.

4.9 In many cases, it will be clear whether or not there exist service recipients or resource providers that are dependent on GPFRs of an entity for information for accountability and decision-making purposes. For example, such users are likely to exist for GPFRs of local bodies, i.e., municipal corporation, municipal councils, etc.. This is because these entities generally have the capacity to raise substantial resources from and/or deploy substantial resources on behalf of their constituents, to incur liabilities, and to impact the economic and/or social well-being of the communities that depend on them for the provision of services.

4.10 However, it may not always be clear whether there are service recipients or resource providers that are dependent on GPFRs of, for example, particular program or identifiable areas of activity/ scheme of local bodies, its departments and agencies for information for accountability and decision-making purposes. Determining whether these programs or activities should be identified as reporting entities and, consequently, be required to prepare GPFRs will involve the exercise of professional judgment.

4.11 The local bodies have a separate identity or standing in law (a legal identity). However, programs and activities without a separate legal identity may also raise or deploy resources, acquire or manage public assets, incur liabilities, undertake activities to achieve service delivery objectives or otherwise implement government policy. Service recipients and resource providers may depend on GPFRs of these programs and activities for information for accountability and decision-making purposes. Consequently, a reporting entity may have a separate legal identity or be, for example, program or activity without a separate legal identity.

CHAPTER 5: ELEMENTS IN FINANCIAL STATEMENTS

CONTENTS

Chapter 5: Elements in Financial Statements

Introduction

Purpose of this Chapter

5.1 This Chapter defines the elements used in financial statements and provides further explanation about those definitions.

Elements and their Importance

5.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and achieves the qualitative characteristics of financial reporting while taking into account the constraints on information included in GPFRs.

5.3 The elements defined in this Chapter do not refer to the individual items that are recognised as a result of transactions and events. Sub-classifications of individual items within an element and aggregations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 8, *Presentation in General Purpose Financial Reports.*

5.4 For a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena and events that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude ASLBs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter

Elements Defined

5.5 The elements that are defined in this Chapter are:

- Assets;
- Liabilities;
- Revenue;
- Expense;
- Ownership contributions[2]; and
- Ownership distributions.

[2] Ownership contribution in case of local bodies denotes the contribution from the Central Government/ respective State Government.

Assets

Definition

5.6 An asset is:

A resource presently controlled by the entity as a result of a past event.

A Resource

5.7 A resource is an item for its own use with service potential or the ability to generate economic benefits, . Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity's rights to a variety of benefits including, for example, the right to:

Use the resource to provide services[3];

- Use an external party's resources to provide services, for example, leases;
- Convert the resource into cash through its disposal;
- Benefit from the resource's appreciation in value; or
- Receive a stream of cash flows.

5.8 Service potential is the capacity of the asset to provide services to the entity that contributes to achieving its objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

5.9 Local Body's assets that embody service potential or economic benefit may include Toll Road, recreational, heritage, community, service of fire tender, ambulance service and other assets which are held by local bodies, and which are used to provide services to third parties with or without appropriate fee or charges. Such services may be for collective or individual consumption. Many services may be provided in areas where there is no market competition or limited market competition. The use and disposal of such assets may be restricted as many assets that embody service potential to the entity are specialised in nature and accordingly such items are recognised as an asset. Some of such assets may be characterised as enabling assets.

5.9 A There are also certain general public utility assets held by the local bodies such as roads, sewerage system, street lights, water treatment plant, etc., which are solely for the public use and are held in trust by the local bodies to perform certain functions as entrusted to them i.e. maintenance and preservance of such assets, therefore, should not be capitalised in the books of Local Bodies. However, memoranda record of such item is shall be maintained mandatorily for their record and administrative control.

5.10 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive

[3] References to "services" in the Conceptual Framework encompass "goods".

one that is part of the operating activities of the entity and it may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows. In other words, economic benefits are cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from, for example:

- An asset's use in the production and sale of services; or
- The direct exchange of an asset for cash or other resources;
- An asset's use in settlement of a liability; or
- Distribution of asset to the government / owners of the entity.

Presently Controlled by the Entity

5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential to the entity and or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential to the entity and or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

Past Event

5.13 The definition of an asset requires that a resource that an entity presently controls must have arisen from a past transaction or other past event. Entities can obtain assets by purchasing them in an exchange transaction or developing them. Assets may also arise through non-exchange transactions, including through the exercising of sovereign powers. The power to tax or to issue licenses and to access or restrict or deny access to the benefits embodied in intangible resources may give rise to assets. In assessing when an entity's control of rights to resources arise the following events may be considered: (a) a general ability to establish a power, (b) establishment of a power through a statute, (c) exercising the power to create a right, and (d) the event which gives rise to the right to receive resources from an external party. An asset arises when the power is exercised and the rights exist to receive resources.

Liabilities

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Local bodies can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

An Outflow of Resources from the Entity

5.16 A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

5.17 To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past transaction or other event and requires an outflow of resources from the entity. The complexity of local body programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity.

Legal and Non-Legally Binding Obligations

5.18 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

5.19 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

5.20 A legal obligation is enforceable in law. Such enforceable obligations may arise from a contract, legislation or other operation of law. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. Obligations that are binding through alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

5.21 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.22 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

5.23 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

5.24 In the local body, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and

- The budget becoming effective (in some cases, the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.

5.25 The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that that the entity has little or no realistic alternative to avoid an outflow of resources include:

- The nature of the past event or events that give rise to the obligation.

  For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that a local body has little option to withdraw. Where a local body has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;

- The ability of the entity to modify or change the obligation before it crystallises. For example, the announcement of policy will generally not give rise to a non-legally binding obligation; and

- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, or through the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.26 “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the local body is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

Net Financial Position, Other Resources, and Other Obligations

5.27 As explained in paragraph 5.4, in some cases, in developing or revising an ASLB, the CASLB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element defined in the Conceptual Framework needs to be recognised in the financial statements. In these cases, the ASLB may require or allow these resources or obligations to be recognised as other resources or other obligations, which are items additional to the six elements defined in this Framework.

5.28 Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognised in the balance sheet. Net financial position can be a positive or negative residual amount.

Revenue and Expense

Definitions

5.29 Revenue is:

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows results in an increases in the net financial position of the entity, other than increases arising from ownership contributions.

5.30 Expense is:

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealised increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and impairments. Revenue and expense may arise from individual transactions or groups of transactions.

Surplus or deficit for the Period

5.32 The entity's surplus or deficit for the period is the difference between revenue and expense reported on the income and expenditure statement.

Ownership Contributions and Ownership Distributions

Definitions

5.33 Ownership contributions are:

Inflows of resources to an entity, contributed by the central government/ respective state government in their capacity as owners, which establish or increase an interest in the net financial position of the entity It includes corpus fund, retained earnings, and reserves.

5.34 Ownership distributions[4] are:

Outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

[4] The concept of ownership distribution may not be relevant for local bodies in normal course where ownership contribution comes from the Central/ respective State Government. However, in certain instances local bodies enter into joint ventures with other entities. In such cases, this concept may apply.

5.35 It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners from revenue and expense. In addition to the injections of resources and the payment of dividends that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between entities. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

5.36 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the local body, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

5.37 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured. Ownership distributions may be: (a) a return on investment; (b) a full or partial return of investment; or (c) in the event of the entity being wound up or restructured, a return of any residual resources.

CHAPTER 6: RECOGNITION IN FINANCIAL STATEMENTS

CONTENTS

Chapter 6: Recognition in Financial Statements

Recognition Criteria and their Relationship to Disclosure

6.1 This chapter identifies the criteria that must be satisfied in order for an element to be recognised in the financial statements. Recognition is the process of incorporating and including in amounts displayed on the face of the appropriate financial statement an item that meets the definition of an element and can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in GPFRs.

6.2 The recognition criteria are that:

- An item satisfies the definition of an element; and
- Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

6.3 All items that satisfy the recognition criteria are recognised in the financial statements. In some circumstances, an ASLB may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognised in the financial statements provided it can be measured in a way that meets the qualitative characteristics and constraints. Other resources and other obligations are discussed in Chapter 5, *Elements in Financial Statements.*

6.4 Recognition involves an assessment of uncertainty related to the existence and measurement of the element. The conditions that give rise to uncertainty, if any, can change. Therefore, it is important that uncertainty is assessed at each reporting date.

Definition of an Element

6.5 In order to be recognised as an element an item must meet the definition of one of the elements in Chapter 5. Uncertainty about the existence of an element is addressed by considering the available evidence in order to decide whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date.

6.6 If it is determined that an element exists, uncertainty about the amount of service potential or ability to generate economic benefits represented by that element is taken into account in the measurement of that element (see paragraphs 6.7 and 6.8). Preparers review and assess all available evidence in determining whether an element exists and is recognised, whether that element continues to qualify for recognition (see paragraph 6.9), or whether there has been a change to an existing element.

Measurement Uncertainty

6.7 In order to recognise an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item achieves the qualitative characteristics, taking into account the constraints on information in GPFRs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognised in the financial statements. The selection of an appropriate measurement basis is considered in Chapter 7, *Measurement of Assets and Liabilities in Financial Statements.*

6.8 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates, and whether additional evidence is available about economic circumstances that existed at the reporting date. Disclosures can provide useful information on estimation techniques employed. There may be rare instances in which the level of uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the measure is questionable even if disclosures are provided to explain estimation techniques. Under these circumstances the item is not recognised.

Disclosure and Recognition

6.9 The failure to recognise items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However, disclosure can provide information about items that meet many, but not all the characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that achieves the qualitative characteristics sufficiently to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

Derecognition

6.10 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognised from the financial statements, and removing the item if such changes have occurred. In evaluating existence uncertainty the same criteria are used for derecognition as at initial recognition.

CHAPTER 7: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

CONTENTS

Chapter 7: Measurement of Assets and Liabilities in Financial Statements

Introduction

7.1 This Chapter identifies the measurement concepts that guide the CASLB in the selection of measurement bases for ASLBs and by preparers of financial statements in selecting measurement bases for assets and liabilities where there are no requirements in ASLBs.

The Objective of Measurement

7.2 The objective of measurement is:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity accountable, and for decision-making purposes.

7.3 The selection of a measurement basis for assets and liabilities contributes to meeting the objectives of financial reporting in the local body by providing information that enables users to assess:

- The cost of services provided in the period in historical or current terms;
- Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and
- Financial capacity—the capacity of the entity to fund its activities.

7.4 The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics while taking into account the constraints on information in financial reports.

Measurement Bases and their Selection

7.5 It is not possible to identify a single measurement basis that best meets the measurement objective at a Conceptual Framework level. Therefore, the Conceptual Framework does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions. It provides guidance on the selection of a measurement basis for assets and liabilities in order to meet the measurement objective.

7.6 The following measurement bases for assets are identified and discussed in terms of the information they provide about the cost of services delivered by an entity, the operating capacity of an entity and the financial capacity of an entity, and the extent to which they provide information that meets the qualitative characteristics:

- Historical cost;
- Market value;
- Replacement cost;
- Net selling price; and

- Value in use.

Table 1 summarises these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) whether or not they are entity-specific.[5]

Table 1: Summary of Measurement Bases for Assets

Measurement Basis	Entry / Exit Value	Observable / Unobservable in a Market	Entity / Non-entity Specific
Historical cost	Entry	Generally observable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity-specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Replacement cost	Entry	Observable	Entity-specific
Net selling price	Exit	Observable	Entity-specific
Value in use	Exit[6]	Unobservable	Entity-specific

7.7 The following measurement bases for liabilities are identified and discussed in terms of (a) the information they provide about the cost of services delivered by an entity, the operating capacity of an entity and the financial capacity of an entity; and (b) the extent to which they provide information that meets the qualitative characteristics:

- Historical cost;
- Cost of fulfillment;
- Market value;
- Cost of release; and
- Assumption price.

[5] In some cases a judgment has been made in classifying a particular measurement basis as observable or unobservable in a market and/or as entity or non-entity specific.

[6] As pointed out in paragraph 7.66, for non-cash-generating assets the calculation of value in use may require the use of replacement cost as surrogate.

Table 2 summarises these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) whether or not they are entity-specific.

Table 2: Summary of Measurement Bases for Liabilities

Measurement Basis	Entry / Exit Value	Observable / Unobservable in a Market	Entity / Non-entity Specific
Historical cost	Entry	Generally observable	Entity-specific
Cost of fulfillment	Exit	Unobservable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity-specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Cost of release	Exit	Observable	Entity-specific
Assumption price	Entry	Observable	Entity-specific

Entry and Exit Values

7.8 Measurement bases may provide either entry or exit values. For assets, entry values reflect the cost of purchase. Historical cost and replacement cost are entry values. Exit values reflect the economic benefits from sale. An exit value also reflects the amount that will be derived from use of the asset. In a diversified economy entry and exit prices differ as entities typically:

- Acquire assets tailored to the entity's particular operating requirements for which other market participants would be unwilling to pay a similar price; and
- Incur transaction costs on acquisition.

7.9 Measurement bases for liabilities may also be classified in terms of whether they are entry or exit values. Entry values relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. Exit values reflect the amount required to fulfill an obligation or the amount required to release the entity from an obligation.

Observable and Unobservable Measures

7.10 Certain measures may be classified according to whether they are observable in an open, active and orderly market. Measures that are observable in a market are likely to be more understandable and verifiable than measures that are not observable. They may also be more faithfully representative of the phenomena they are measuring.

Entity-Specific and Non-Entity Specific Measures

7.11 Measures may also be classified according to whether they are "entity-specific" or "non-entity-specific". Measurement bases that are entity-specific reflect the economic and current policy constraints that affect the possible uses of an asset and the settlement of a liability by an entity. Entity-specific measures may reflect economic opportunities that are not available to other entities and risks that are not experienced by other entities. Non-entity-specific measures reflect general market opportunities and risks. The decision on whether to use an entity-specific or non-entity-specific measure is taken by reference to the measurement objective and the qualitative characteristics.

Level of Aggregation or Disaggregation for Measurement

7.12 In order to present assets and liabilities in the financial statements in a way that provides information that best meets the measurement objective and achieves the qualitative characteristics it may be necessary to aggregate or disaggregate them for measurement purposes. In assessing whether such an aggregation or disaggregation is appropriate the costs are compared with the benefits.

Measurement Bases for Assets

(I) Historical Cost

7.13 Historical cost for an asset is:

The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.

7.14 Historical cost is an entry, entity-specific value.[7] Under the historical cost model assets are initially reported at the cost incurred on their acquisition. Subsequent to initial recognition, this cost may be allocated as an expense to reporting periods in the form of depreciation or amortisation for certain assets, as the service potential or ability to generate economic benefits provided by such assets are consumed over their useful lives. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices or increases in the value of the asset.

7.15 Under the historical cost model the amount of an asset may be reduced by recognising impairments. Impairment is the extent to which the service potential or ability to generate economic benefits provided by an asset have diminished due to changes in economic or other conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements (excluding price increases for unimproved assets) or other events, such as the accrual of interest on a financial asset.

[7] The term "historical cost" may also be referred to as the "cost model" or generically as "cost-based measures."

Costs of Services

7.16 Where historical cost is used, the cost of services reflects the amount of the resources expended to acquire or develop assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. Because the costs used are those carried forward from an earlier period without adjustment for price changes, they do not reflect the cost of assets when the assets are consumed. As the cost of services is reported using past prices, historical cost information will not facilitate the assessment of the future cost of providing services if cumulative price changes since acquisition are significant.

Operational Capacity

7.17 If an asset has been acquired in an exchange transaction, historical cost provides information on the resources available to provide services in future periods, based on their acquisition cost. At the time an asset is purchased or developed, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.[8] When depreciation or amortisation is recognised it reflects the extent to which the service potential of an asset has been consumed. Historical cost information shows that the resources available for future services are at least as great as the amount at which they are stated. Increases in the value of an asset are not reflected under the historical cost model. If an asset has been acquired in a non-exchange transaction the transaction price will not provide information on operating capacity.

Financial Capacity

7.18 The amount at which assets are stated in financial statements assists in an assessment of financial capacity. Historical cost can provide information on the amount of assets that may be used as effective security for borrowings. An assessment of financial capacity also requires information on the amount that could be received on sale of an asset, and reinvested in assets to provide different services. Historical cost does not provide this information when significantly different from current exit values.

Application of the Qualitative Characteristics

7.19 Paragraphs 7.16–7.18 explain the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward, because transaction information is usually readily available. As a result amounts derived from the historical cost model are generally representationally faithful in that they represent what they purport to represent—that is, the cost to acquire or develop an asset based on actual transactions. Estimates of depreciation and impairment used in the historical cost model, particularly for noncash-generating assets, can affect representational faithfulness. Because application of historical cost generally reflects resources consumed by reference to actual transactions, historical cost measures are verifiable, understandable and can be prepared on a timely basis.

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[8] Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

7.20 Historical cost information is comparable to the extent that assets have the same or similar acquisition dates. Because historical cost does not reflect the impact of price changes, it is not possible to compare the amounts of assets that were acquired at different times when prices differed in a meaningful way.

7.21 In certain circumstances the application of historical cost necessitates the use of allocations—for example where:

- Several assets are acquired in a single transaction;
- Assets are constructed by the entity itself and overheads and other costs have to be attributed; and
- The use of a flow assumption, such as first-in-first-out, is necessary when many similar assets are held. To the extent such allocations are arbitrary they reduce the extent to which the resulting measurement achieves the qualitative characteristics.

(II) Current Value Measurements

7.22 Current value measurements reflect the economic environment prevailing at the reporting date.

7.23 There are four current value measurement bases for assets:

- Market value;
- Replacement cost;
- Net selling price; and
- Value in use.

(i) Market Value

7.24 Market value for assets is:

The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

7.25 At acquisition market value and historical cost will be the same, if transaction costs are ignored and the transaction is an exchange transaction. The extent to which market value meets the objectives of financial reporting and the information needs of users partially depends on the quality of the market evidence. Market evidence, in turn, depends upon the characteristics of the market in which the asset is traded. Market value is particularly appropriate where it is judged that the difference between entry and exit values is unlikely to be significant or the asset is being held with a view to sale.

7.26 In principle, market values provide useful information because they fairly reflect the value of the asset to the entity. In an open, active and orderly market (see paragraph 7.28), the asset cannot be worth less than market value as the entity can obtain that amount by selling the asset, and cannot be worth more than market value, as the entity can obtain equivalent service potential or the ability to generate economic benefits by purchasing the same asset.

7.27 The usefulness of market values is more questionable when the assumption that markets are open, active and orderly does not hold. In such circumstances it cannot be assumed that the asset may be sold for the same price as that at which it can be acquired and it is necessary to determine whether an exit price or an entry price is the more useful measure. Exit-based market values are useful for assets that are held for trading, such as certain financial instruments, but may not be useful for specialised operational assets. Furthermore, while the purchase of an asset provides evidence that the value of the asset to the entity is at least as great as its purchase price, operational factors may mean that the value to the entity may be greater. Hence market values may not reflect the value to the entity of the asset, represented by its operational capacity.

Market Values in Open, Active and Orderly Markets

7.28 Open, active and orderly markets have the following characteristics:

- There are no barriers that prevent the entity from transacting in the market;
- They are active so there is sufficient frequency and volume of transactions to provide price information; and
- They are orderly, with many well-informed buyers and sellers acting without compulsion, so there is assurance of "fairness" in determining current prices—including that prices do not represent distress sales.

An orderly market is one that is run in a reliable, secure, accurate and efficient manner. Such markets deal in assets that are identical and therefore mutually interchangeable, such as commodities, currencies and securities where prices are publicly available. In practice few, if any, markets fully exhibit all of these characteristics, but some may approach an orderly market as described.

Market Values where it cannot be Assumed that Markets are Open, Active and Orderly

7.29 Markets for assets that are unique and rarely traded are not open, active and orderly: any purchases and sales are individually negotiated, and there may be a large range of prices at which a transaction might be agreed. Therefore, participants will incur significant costs to purchase or to sell an asset. In such circumstances it is necessary to use an estimation technique to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions.

Costs of Services

7.30 Revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. If assets used to provide services are measured at market value, the allocation of the cost of assets to reflect their consumption in the current reporting period is based on the current market value of the asset.

7.31 The use of market values permits a return on assets to be determined. However, local Bodies do not generally carry out activities with the primary objective of generating profits, and services are often provided in non-exchange transactions or on subsidized terms. Consequently, there may be limited relevance in a reported return derived from exit-based market prices.

7.32 As noted above, revenue from providing services reported in financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for a period includes price movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity would be able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is realized on sale. However, where assets used to provide services are not traded on open, active and orderly markets, or a close approximation to such markets, the relevance of revenue and expense related to changes in market value is more questionable.

Operational Capacity

7.33 Information on the market value of assets held to provide services in future periods is useful if it reflects the value that the entity is capable of deriving from assets by using them in providing or delivering services. However, if an exit-based market value is significantly lower than historical cost, market value is likely to be less relevant than the historical cost of such assets in providing information on operational capacity—such a market value is also likely to be less relevant than entry value-based current measures

Financial Capacity

7.34 An assessment of financial capacity requires information on the amount that would be received on sale of an asset. This information is provided by market value.

Application of the Qualitative Characteristics

7.35 Values determined in open, active and orderly markets can be readily used for financial reporting purposes. The information will meet the qualitative characteristics—that is it will be relevant, representationally faithful, understandable, comparable, and verifiable. Under such market conditions entry and exit values can be assumed to be the same or very similar. Because it can be prepared quickly, such information is also likely to be timely.

7.36 The extent to which market values meet the qualitative characteristics will decrease as the quality of market evidence diminishes and the determination of such values relies on estimation techniques. As indicated above, exit-based market values are only likely to be relevant to assessments of financial capacity.

(ii) Replacement Cost

7.37 Replacement cost[9] is:

The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.

7.38 Replacement cost differs from market value because:

- In a local body context it is explicitly an entry value that reflects the cost of replacing the service potential of an asset;
- It includes all the costs that would necessarily be incurred in the replacement of the service potential of an asset; and
- It is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing in a hypothetical market. For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles individually.

7.39 Because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflects the replacement of service potential in the normal course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event, such as a fire.

7.40 Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach and differs from reproduction cost, which is the cost of acquiring an identical asset.[10] Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost is based on an alternative asset if that alternative would provide the same service potential more cheaply. For financial reporting purposes, it is therefore necessary to reflect the difference in service potential between the existing and replacement asset.

7.41 The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore, the replacement cost of an asset reflects reductions in required service capacity. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since

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9 The full term is "optimised depreciated replacement cost" to denote that it refers to the replacement of the service potential embodied in an asset and not the asset itself. (see paragraph 7.41) The term "replacement cost" is used for economy of expression in the Framework.

10 There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.

its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

7.42 In some cases the value that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to measure the asset at that value, as it includes benefits from future activities, rather than service potential at the reporting date. Replacement cost represents the highest potential value of an asset, as, by definition, the entity is able to secure equivalent service potential by incurring replacement cost.

Costs of Services

7.43 Replacement cost provides a relevant measure of the cost of the provision of services. The cost of consuming an asset is equivalent to the amount of the sacrifice of service potential incurred by that use. That amount is its replacement cost—the entity is able to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost.

7.44 The costs of services are reported in current terms when based on replacement cost. Thus the amount of assets consumed is stated at the value of the assets at the time they are consumed—and not, as with historical cost, at the time they were acquired. This provides a valid basis for a comparison between the cost of services and the amount of taxes and other revenue received in the period—which are generally transactions of the current period and measured in current prices—and for assessing whether resources have been used economically and efficiently. It also provides a useful basis for comparison with other entities that report on the same basis, as asset values will not be affected by different acquisition dates, and for assessing the cost of providing services in the future and future resource needs, as future costs are more likely to resemble current costs than those incurred in the past, when prices were different (see also paragraph 7.48).

Operational Capacity

7.45 In principle, replacement cost provides a useful measure of the resources available to provide services in future periods, as it is focused on the current value of assets and their service potential to the entity.

Financial Capacity

7.46 Replacement cost does not provide information on the amounts that would be received on the sale of assets. It therefore does not facilitate an assessment of financial capacity.

Application of the Qualitative Characteristics

7.47 As noted above, replacement cost is relevant to assessments of the cost of services and operational capacity. It is not relevant to assessments of financial capacity. In some circumstances calculation of replacement cost is complex, and subjective judgments are required. These factors may reduce the representational faithfulness of replacement cost. In these circumstances the timeliness, comparability and verifiability of information prepared on a replacement cost basis may be affected, and replacement cost may be more costly than some alternatives. Replacement cost information may also not be straightforward to understand, particularly when that information reflects a reduction in required service capacity (see paragraph 7.41).

7.48 Replacement cost information is comparable within an entity as assets that provide equivalent service potential are stated at similar amounts, regardless of when those assets were acquired. In principle different entities may report similar assets at different amounts, because replacement cost is an entity-specific measure that reflects the opportunities for replacement that are available to the entity. The opportunities for replacement may be the same or similar for different entities. Where they are different, the economic advantage of an entity that is able to acquire assets more cheaply is reported in financial statements through lower asset values and a lower cost of services in order to be representationally faithful.

(iii) Net Selling Price

7.49 Net selling price is:

The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.

7.50 Net selling price differs from market value in that it does not require an open, active and orderly market or the estimation of a price in such a market and that it includes the entity's costs of sale. Net selling price therefore reflects constraints on sale. It is entity-specific.

7.51 The potential usefulness of measuring assets at net selling price is that an asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. However, it is not appropriate as a measurement basis if the entity is able to use its resources more efficiently by employing the asset in another way, for example by using it in the delivery of services.

7.52 Net selling price is therefore useful where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or the ability to generate economic benefits at least as valuable as net selling price. Net selling price may provide useful information where an entity is contractually obligated to sell an asset at below market value. There may be cases where net selling price can indicate a development opportunity.

Costs of Services

7.53 It is not appropriate to quantify the cost of the provision of services at net selling prices. Such an approach would involve the use of an exit value as the basis of the expense reported.

Operational Capacity

7.54 Stating assets held for use in the provision of services at net selling price does not provide information useful to an assessment of operating capacity. Net selling price shows the amount that could be derived from an asset's sale, rather than the value of the service potential that could be derived from that asset.

Financial Capacity

7.55 As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Such information is provided by the use of net selling price. However, such a measure is not relevant for assets that may yield more valuable service potential by continuing to use them to deliver services.

Application of the Qualitative Characteristics

7.56 As indicated in paragraph 7.52 net selling price provides relevant information only where the most resource-efficient course available to the entity is to sell the asset. Assessments of net selling price may be made by reference to active markets where they exist. For major assets it may be possible and cost-effective to obtain professional appraisals. Net selling price will generally provide understandable information.

7.57 In most cases where net selling price is relevant, it will achieve the qualitative characteristics of faithful representation, verifiability, and timeliness.

(iv) Value in Use

7.58 Value in use is:

The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

Suitability of Value in Use

7.59 Value in use is an entity-specific value that reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 7.42 above, the value that will be derived from an asset is often greater than its replacement cost—it is also usually greater than its historical cost. Where this is the case, reporting an asset at its value in use is of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.

7.60 Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.

7.61 Therefore, value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its service potential or ability to generate economic benefits is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.

7.62 Value in use is an appropriate measurement basis for the assessment of certain impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

Costs of Services, Operational Capacity, Financial Capacity

7.63 Because of its potential complexity[11], its limited applicability and the fact that its operationalisation in a local body context for non-cash-generating assets involves the use of replacement cost as a surrogate, value in use is generally inappropriate for determining the cost of services. Its usefulness to assessments of operational capacity is limited, and is only likely to be significant in the atypical circumstances where entities have a large number of assets that are not worth replacing, but their value in use is greater than their net selling price. This may be the case if, for example, an entity will discontinue provision of a service in the future, but the proceeds of immediate sale are less than the service potential embodied in the assets. Value in use does involve an estimate of the net amount that an entity will receive from disposal of the asset. However, its limited applicability reduces its relevance for assessments of financial capacity.

Application of the Qualitative Characteristics

7.64 While value in use may be used in assessments of certain impairments its relevance for financial reporting purposes is limited to the circumstances outlined in paragraph 7.61.

7.65 The extent to which value in use meets the other qualitative characteristics depends on how it is determined. In some cases, an asset's value in use can be quantified by calculating the value that the entity will derive from the asset assuming its continued use. This may be based on the future cash inflows related to the asset, or on cost savings that will accrue to the entity through its control of the asset. The calculation of value in use takes into account the time value of money and, in principle, the risk of variations in the amount and timing of cash flows.

7.66 The calculation of value in use can be complex. Assets that are employed in cash-generating activities often provide cash flows jointly with other assets. In such cases value in use can be estimated only by calculating the present value of the cash flows of a group of assets and then making an allocation to individual assets.

7.67 In the local body, most assets are held with the primary objective of contributing to the provision of services, rather than to the generation of a commercial return: such assets are referred to as "non-cash-generating assets." Because value in use is usually derived from expected cash flows, its operationalisation in such a context can be difficult. It may be inappropriate to calculate value in use on the basis of expected cash flows, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. Therefore, it would be necessary to use replacement cost as a surrogate for financial reporting purposes.

7.68 The method of determining value in use reduces its representational faithfulness in many cases. It also affects the timeliness, comparability, understandability and verifiability of information prepared on a value in use basis.

[11] See below paragraph 7.66

Measurement Bases for Liabilities

7.69 This section discusses the measurement bases for liabilities. This section does not repeat all the discussion the section on assets. It considers the following measurement bases:

- Historical Cost;
- Cost of Fulfillment;
- Market Value;
- Cost of Release; and
- Assumption Price

(I) Historical Cost

7.70 Historical cost for a liability is:

The consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

7.71 Under the historical cost model initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortisation of a premium.

7.72 Where the time value of a liability is material—for example, where the length of time before settlement falls due is significant— the amount of the future payment is discounted so that, at the time a liability is first recognised, it represents the value of the amount received. The difference between the amount of the future payment and the present value of the liability is amortised over the life of the liability, so that the liability is stated at the amount of the required payment when it falls due.

7.73 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets. Historical cost is appropriate where liabilities are likely to be settled at stated terms. However, historical cost cannot be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages. It is also unlikely to provide relevant information where the liability has been incurred in a non-exchange transaction, because it does not provide a faithful representation of the claims against the resources of the entity. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

(II) Cost of Fulfillment

7.74 Cost of fulfillment is:

The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

7.75 Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.

7.76 Where fulfillment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

7.77 Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a claim on the entity's resources—this is consistent with the approach for assets, where replacement cost would include the profit required by a supplier, but no profit would be included in the replacement cost for assets that the entity would replace through self-construction.

7.78 Where fulfillment will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the reporting date.

7.79 Cost of fulfillment is generally relevant for measuring liabilities except in the following circumstances:

- Where the entity can obtain release from an obligation at a lower amount than cost of fulfillment, then cost of release is a more relevant measure of the current burden of a liability, just as, for an asset, net selling price is more relevant when it is higher than value in use.

- In the case of liabilities assumed for a consideration, assumption price (see paragraphs 7.87-7.91) is more relevant when assumption price is higher than both cost of fulfillment and cost of release.

(III) Market Value

7.80 Market value for liabilities is

The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.

7.81 The advantages and disadvantages of market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, where the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market. However, in cases where the ability to transfer a liability is restricted and the terms on which such a transfer might be made are unclear the case for market values, even if they exist, is significantly weaker. This is particularly the case for liabilities arising from obligations in non-exchange transactions, because it is unlikely that there will be an open, active and orderly market for such liabilities.

(IV) Cost of Release

7.82 "Cost of release" is the term used in the context of liabilities to refer to the same concept as "net selling price" in the context of assets. Cost of release refers to the amount of an immediate exit from the obligation. Cost of release is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount—this is consistent with the approach for assets, where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.

7.83 For some liabilities, particularly in the local body, transfer of a liability is not practically possible and cost of release will therefore be the amount that the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor—for example, where a contract includes a specific cancellation clause.

7.84 In some cases there may be evidence of the price at which a liability may be transferred—for example, in the case of some pension liabilities. Transferring a liability may be distinguished from entering into an agreement with another party that will fulfill the entity's obligation or bear all the costs stemming from a liability. For a liability to be transferred it is necessary that all of the creditor's rights against the entity are extinguished. If this is not the effect of an arrangement, the liability remains a liability of the entity.

7.85 In assessing whether cost of release is appropriate for measuring liabilities it is necessary to consider whether release in the envisaged manner is an option that is open to the entity in practice, having regard to any consequences of obtaining release, such as damage to the entity's reputation.

7.86 Just as net selling price is relevant only when the most resource-efficient course available to the entity is to sell the asset, so cost of release is relevant only when the most resource-efficient course is to seek immediate release from an obligation. In particular, where cost of fulfillment is lower than cost of release, cost of fulfillment provides more relevant information than cost of release, even if it is feasible to negotiate a release from the obligation in accordance with the methods for transferring a liability in paragraph 7.84.

(V) Assumption Price

7.87 "Assumption price" is the term used in the context of liabilities to refer to the same concept as replacement cost for assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price—this is not the case for non-exchange transactions.

7.88 In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release—

i.e., the settlement amount. Once that assumption price has been received by the entity, the entity has an obligation to its creditor.

7.89 At the time a liability is first incurred in an exchange transaction, assumption price represents the amount that was accepted by the entity for assuming the liability—it is therefore usually reasonable to assume that assumption price is the price that the entity would rationally accept for assuming a similar liability. It would charge a higher amount, if competitive pressures allowed it to do so, but it might be unwilling to accept a lower price. Just as replacement cost is a current value so, conceptually, is assumption price. There are, however, practical problems in reflecting changes in prices in obligations that are stated at assumption price.

7.90 A consequence of stating performance obligations at the assumption price is that no surplus is reported at the time the obligation is taken on. A surplus or deficit is reported in the financial statements in the period when fulfillment (or release) takes place, as it is the difference between the revenue arising from satisfaction of the liability and the cost of settlement.

7.91 An entity may have a potential obligation that is larger than assumption price. If the entity has to seek release from a contract, the other party to the contract may be able to claim recompense for losses that it will sustain, as well as the return of any amounts paid. However, provided that the entity can settle the obligation by fulfillment, it can avoid such additional obligations and it is representationally faithful to report the obligation at no more than assumption price—this is analogous to the position where an asset will yield greater benefits than replacement cost. Under such circumstances, as explained in paragraph 7.42, replacement cost rather than value in use is the most relevant measurement basis.

CHAPTER 8: PRESENTATION IN GENERAL PURPOSE FINANCIAL REPORTS

CONTENTS

Chapter 8: Presentation in General Purpose Financial Reports

Introduction

8.1 This Chapter sets out the concepts applicable to the presentation of information in GPFRs, including financial statements of entities.

8.2 Presentation is linked to Chapters 1 to 4—the objectives of financial reporting, users' needs, the qualitative characteristics, constraints on information included in GPFRs and the reporting entity all influence presentation decisions. For information reported in the financial statements, presentation is also linked to the definitions of the elements, recognition criteria and measurement bases identified in Chapters 5 to 7-—for example:

- The definition of the elements affects the items that can be presented in the financial statements;
- Application of the recognition criteria affects the location of information; and,
- The selection of measurement bases impacts the information presented on measurement methodologies.

Language in which Financial Statement and Other GPFRs are Issued

8.3 The language (or languages) in which financial statements and other GPFRs are issued supports achievement of the objectives of financial reporting and the qualitative characteristics. All translated versions need to be faithful to the original language version. The translated version is made available to meet the needs of users with reference to:

- Legal requirements in the entity's jurisdiction; and
- Translation costs and benefits.

Presentation

8.4 Presentation is the selection, location and organisation of information that is reported in the GPFRs.

8.5 Presentation aims to provide information that contributes towards the objectives of financial reporting and achieves the qualitative characteristics while taking into account the constraints on information included in GPFRs. Decisions on selection, location and organisation of information are made in response to the needs of users for information about economic or other phenomena.

8.6 Chapter 1 explains that GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters included within the scope of financial reporting. In addition to the financial statements, GPFRs provide information relevant to, for example, assessments of an entity's service performance and the sustainability of its finances. The objectives of financial reporting, applied to the area covered by a particular report, guide presentation decisions for that report.

8.7 Presentation decisions may:

- Result in the development of a new GPFR, the movement of information between reports, or the amalgamation of existing reports; or,

- Be detailed decisions on information selection, location and organisation within a GPFR.

Presentation Decisions are Interlinked

8.8 Decisions on information selection, location and organisation are interlinked and, in practice, are likely to be considered together. The amount or type of information selected could have implications on whether it is included in a separate report or organised into tables or separate schedules. The following three sections separately focus on each presentation decision.

Information Selection

8.9 Decisions on information selection address what information is reported:

- In the financial statements; and

- In GPFRs outside the financial statements (other GPFRs).

8.10 As Chapter 2, *Objectives and Users of General Purpose Financial Reporting*, explains, the objectives of financial reporting are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes. Chapter 2 describes the types of information that users need to meet the objectives of financial reporting. That description guides decisions on whether particular types of reports are needed. This Chapter focuses on the selection of information to be presented in GPFRs, including financial statements and other reports.

Information Selection—Nature of Information

Nature of Information in Financial Statements

8.11 Users' information needs identified in Chapter 2 underpin information selection for the financial statements. Those needs include information about the financial position, financial performance and cash flows of an entity in order to:

- Enable users to identify the resources of the entity and claims on those resources at the reporting date;

- Inform assessments of matters such as whether the entity has acquired resources economically, and used them efficiently and effectively to achieve its service delivery objectives; and,

- Inform assessments of financial performance and the entity's liquidity and solvency.

8.12 The financial statements may also provide information that assists users in assessing the extent to which:

- An entity has met its financial objectives;

- Revenues, expenses, cash flows and financial results of the entity comply with approved budgets; and

- An entity has adhered to relevant legislation or other authority governing the raising and use of public monies.

8.13 The financial statements do not report comprehensively on an entity's service performance. However, information in the financial statements may provide information relevant to the financial aspects of service performance such as information about:

- Revenue, expenses and cash flows related to services; and

- The assets and liabilities that inform users' evaluations of, for example, an entity's operational capacity or financial risks that could impact on service provision.

8.14 Other reports in GPFRs present information additional to the financial statements. Such information could, for example, include:

- Information on the sustainability of an entity's public finances;

- Financial statement discussion and analysis; or

- Service performance information.

Information Selected for Display or Disclosure

8.15 Information is selected for display or disclosure in GPFRs. Information selected for display communicates key messages in a GPFR, while information selected for disclosure makes displayed information more useful by providing detail that will help users to understand the displayed information. Disclosure is not a substitute for display.

8.16 Repetition of information in a GPFR needs to be generally be avoided. However, the same information may be both displayed and disclosed. For example, a total displayed on the face of the financial statements may be repeated in the notes, where the notes provide a disaggregation of the displayed total. Similarly, the same information may be presented in different GPFRs in order to address their different aims.

Information Selected for Display

8.17 Every GPFR contains key messages that are communicated, so every GPFR contains displayed information. Displayed information is kept to a concise, understandable level, so that users can focus on the key messages presented and not be distracted by detail that could otherwise obscure those messages. Displayed information is presented prominently, using appropriate presentation techniques such as clear labeling, borders, tables and graphs.

8.18 The items displayed on the face of the financial statements provide information about such matters as the reporting entity's financial position, financial performance and cash flows.

8.19 Assessment of whether an item satisfies the recognition criteria is one of the key mechanisms in determining whether information is displayed on the face of the balance sheet or income and expenditure statement and/or disclosed either in the notes or elsewhere in the GPFRs. In other cases, for example a statement of cash flows, displayed information will also support achievement of the objectives of financial reporting.

8.20 Developing requirements for the display of line items and totals involves balancing the standardisation of displayed information, which facilitates understandability, with information that is tailored for entity-specific factors. The aim of both standardised display requirements and entity specific information is to ensure that information necessary to meet the objectives of financial reporting is available for all entities, while allowing information to be displayed in a manner that reflects the nature and operations of specific entities.

Information Selected for Disclosure

8.21 Disclosed information is likely to include:

- The basis for the displayed information, such as applicable policies or methodologies;
- Disaggregations of displayed information; and,
- Items that share some but not all of the aspects of displayed information—for example disclosures on items that meet some, but not all, of the characteristics of the definition of an element[12] or disclosures on items that meet the definition of an element, but not the recognition criterion.

8.22 The level of detail provided by disclosed information contributes to achievement of the objectives of financial reporting, without being excessive. Disclosed information, like displayed information, is necessary for achievement of the objectives of financial reporting.

8.23 Information disclosed in the notes to the financial statements:

- Is necessary to a user's understanding of the financial statements;

[12] Chapter 5, *Elements in Financial Statements*, explains that other resources and other obligations that do not meet the definition of elements may be recognised in order to contribute to the objectives of financial reporting.

- Provides information that presents the financial statements in the context of the entity and its operating environment; and

- Generally, will have a clear and demonstrable relationship to information displayed on the face of the financial statement(s) to which it pertains.

8.24 Information disclosed in the notes may also include:

- Entity-related factors that could influence judgments about reported information (for example, information about related parties and controlled entities or interests in other entities);

- The basis for what is displayed (for example, information on accounting policies and measurement, including measurement methods and measurement uncertainties where applicable);

- Disaggregations of amounts displayed on the face of the statements (for example, a breakdown of property, plant and equipment into different classes);

- Items that do not meet the definition of an element or the recognition criteria, but are important to an understanding of the entity's finances and ability to deliver services— for example, information about events and conditions, that might affect future cash flows or service potential, including their natures, possible effects on cash flows or service potential, probabilities of occurrence, and sensitivities to changes in conditions; and,

- Information that may explain underlying trends affecting displayed totals.

Principles Applicable to Information Selection

8.25 Decisions about what information needs to be displayed and disclosed involve consideration of:

- The objectives of financial reporting;

- The qualitative characteristics and constraints on information included in GPFRs; and

- The relevant economic or other phenomena about which information may be necessary.

8.26 Information selection results in information that contributes to meeting the objectives of financial reporting, as applied to the area covered by a particular report, and provides the appropriate level of detail. Decisions on information selection involve information prioritisation and summarisation. Information selection avoids information overload that reduces understandability. Too much information may make it difficult for users to understand the key messages, and, consequently undermines achievement of the objectives of financial reporting.

8.27 Preparers, applying pronouncements and their professional judgment, are responsible for ensuring that information that meets the objectives of financial reporting and achieves the qualitative characteristics is provided in the GPFRs that they prepare.

8.28 Decisions on information selection require continuing and critical review. Information identified for possible selection is reviewed as it is developed and considered for presentation, with particular reference to its relevance, materiality and cost-benefit, although all the qualitative characteristics and constraints are applied to decisions on information selection. Past decisions may require reconsideration because new information may make existing information requirements redundant with the result that those items no longer achieve the qualitative characteristics and/or the constraints.

8.29 All material transactions, events, and other items reported are presented in a manner that conveys their substance rather than their legal or other form so that the qualitative characteristics of relevance and representational faithfulness are achieved.

8.30 The benefits to users of receiving information need to justify the costs to entities of collecting and presenting that information. In making this assessment it is important to consider how individual items impact on the overall view presented and the nature of the information presented. Items that may appear to have little benefit when viewed in isolation could have much greater benefit in contributing to the complete set of information presented.

8.31 Information needs to be presented on a sufficiently timely basis to enable users to hold a management accountable and to inform users' decisions.

8.32 GPFRs may include additional information derived from sources other than the financial information system. The qualitative characteristics apply to such information. The date of delivery of any such additional information needs to be as close as possible to the financial statements' reporting date, so that reported information will be timely.

Principles for Selection of Information for Display and Disclosure

8.33 Decisions about display or disclosure apply to both the financial statements and other GPFRs. The objectives of financial reporting are applied to the area covered by a particular report to guide the identification of information for display or disclosure. The identification of information for display and disclosure in a particular GPFR may involve the development of:

- Classification principles;
- A list of broad types of information that are displayed and a similar list of broad types of information that are disclosed; and/or,
- Lists of specific information that preparers must display or disclose.

8.34 Decisions about selection of information to be displayed and disclosed are made:

- With reference to each other rather than in isolation; and
- To effectively communicate an integrated set of information.

8.35 Selection decisions with respect to information in other GPFRs are made after carefully considering the relationship of the other GPFRs to the financial statements.

Information Location

8.36 Decisions on information location are made about which:

- Report information is located within; and
- Component of a report information is located.

8.37 The location of information has an impact on information's contribution to achievement of the objectives of financial reporting and the qualitative characteristics. Location may affect the way that users interpret information and the comparability of information. Location may be used to:

- Convey the relative importance of information and its connections with other items of information;
- Convey the nature of information;
- Link different items of information that combine to meet a particular user need; and
- Distinguish between information selected for display and information selected for disclosure.

Principles for Allocation of Information between Different Reports

8.38 Factors relevant to decisions about allocating information between the financial statements and another GPFR include:

- *Nature*: Whether the nature of the information, for example historical versus prospective, supports including the information either in the same or a different GPFR, because of considerations related to, for example, comparability and/or understandability;
- *Jurisdiction-Specific:* Whether jurisdiction-specific factors, such as legal provisions, specify requirements on information location; and
- *Linkage:* Whether or not the additional information envisaged needs to link very closely to information already included in an existing report. The linkages between all information need to be assessed, not only linkages between new and existing information.

8.39 The factors above, which are expressed from the perspective of adding information to an existing set of information, also apply to considerations of whether the grouping of existing information could be improved, which is discussed in the section on information organisation.

8.40 A separate GPFR may be necessary when:

- Additional user information needs, not satisfied by an existing report, are identified; and

- A separate GPFR to meet those needs is more likely to achieve the objectives of financial reporting and the qualitative characteristics than including information in an existing report.

Principles for Location of Information within a Report

8.41 Paragraph 8.17 of this Chapter states that displayed information is presented prominently, using appropriate presentation techniques—location is one way to achieve this. Information location within a report ensures that displayed information is given appropriate prominence and is not obscured by more detailed and extensive disclosed information.

8.42 The location of information in the financial statements contributes to communicating a comprehensive financial picture of an entity.

8.43 For the financial statements, displayed information is shown on the face of the appropriate statement, while disclosures are in the notes. Distinguishing displayed information and disclosed information through location ensures that those items that directly relate to communicating matters, such as an entity's financial position, financial performance and cash flows, can be highlighted, with further more detailed information provided through disclosure in the notes.

8.44 For other GPFRs, displayed information may either be located separately from disclosed information or located in the same area, but distinguished from disclosed information and given prominence through the use of another presentation technique.

Information Organisation

8.45 Information organisation addresses the arrangement, grouping and ordering of information, which includes decisions on:

- How information is arranged within a GPFR; and

- The overall structure of a GPFR.

8.46 Information organisation involves a range of decisions including decisions on the use of cross referencing, tables, graphs, headings, numbering, and the arrangement of items within a particular component of a report, including decisions on item order. How information is organised can affect its interpretation by users.

Nature of Information Relevant to Organisation

8.47 Decisions about the organisation of information take into account:

- Important relationships between information; and

- Whether information is for display or disclosure.

Types of Relationships

8.48 Important relationships include, but are not restricted to:

- Enhancement;
- Similarity; and
- Shared purpose.

8.49 *Enhancement*: Information in one place in a GPFR may be enhanced through information provided elsewhere. For example, budget, prospective and service performance information enhances information in the financial statements. Tables and graphs may be used to enhance the understanding of narrative information. Links to information reported outside the GPFRs may enhance the understandability of information reported in GPFRs.

8.50 *Similarity*: A relationship of similarity exists where information reported in one place is based on information reported elsewhere in the GPFRs, and the information either has not been adjusted or has had relatively minor adjustments. For example, if service performance information includes the cost of services, or the value of assets used in different services, then it may be helpful to show how those totals relate to expense and assets reported in the financial statements. Another example is the relationship between the total expense reported against budget and total expense reported in the income and expenditure statement. A reconciliation between the two different amounts can enhance users' understanding of an entity's finances.

8.51 *Shared purpose*: A relationship of shared purpose exists where information reported in different places contributes to the same purpose. An example is where different statements and disclosures provide information needed for assessments of accountability for services delivered. Information about (a) the actual and budgeted cost of different services, (b) financial and non-financial resources used in the provision of different services, and (c) future provision of different services may be included in different places. To make the relationship between the information in different places clear, it may be appropriate to organise the information by using techniques such as common headings and referencing.

8.52 Relationships may exist between information in different:

- GPFRs;
- Components within a GPFR; and
- Parts of a single component.

Grouping of Information

8.53 The three factors noted the section on information selection as being applicable to decisions on information location—linkage, nature of information and jurisdiction-specific considerations—also apply to considerations of whether the grouping of existing information could be improved.

Decisions on effective grouping of information consider linkages between information sets, the nature of the different information sets, and, to the extent appropriate, jurisdiction-specific factors.

Principles Applicable to Information Organisation

8.54 Information organisation:

- Supports achievement of the objectives of financial reporting; and
- Helps reported information meet the qualitative characteristics.

8.55 Information organisation:

- Helps to ensure that key messages are understandable;
- Clearly identifies important relationships;
- Gives appropriate prominence to information that conveys key messages; and
- Facilitates comparisons.

8.56 Related information is linked through the use of consistent headings, presentation order, and/or other methods appropriate to the relationship and type of information. Where links are to information reported outside the GPFRs it is important that:

- Links to information from other sources do not undermine a GPFR's achievement of the qualitative characteristics; and
- The issuance date of any such linked information is as close as possible to the financial statements' reporting date so that reported information will be timely.

Comparability

8.57 Information organisation takes into account the benefits of consistent presentation over time. Consistent presentation supports users' ability to understand information and facilitates their access to information. It helps to achieve the qualitative characteristic of comparability.

Principles for Information Organisation within the Financial Statements

8.58 Information displayed on the face of the financial statements is usually organised into numeric totals and sub-totals. Its organisation provides a structured overview of such matters as the reporting entity's financial position, financial performance and cash flows.

8.59 For the financial statements, relationships may exist between:

- Subsets of displayed amounts or changes in displayed amounts and their impact on an entity's financial position, financial performance and/or cash flows;

- Different displayed amounts in different financial statements, which all reflect the impact of a common external event, or contribute together towards an understanding of an aspect of the entity's financial position or financial performance; and,

- Displayed amounts and related note disclosures that provide information that explains or could otherwise support users' understanding of displayed items.

8.60 The organisation of information in financial statements includes decisions on:

- The type and number of statements;
- Disaggregation of totals into meaningful subcategories;
- Ordering and grouping of items displayed within each statement;
- Identification of aggregates (additive and subtractive); and,
- Identification of other information for inclusion on the face of the statement.

8.61 Information disclosed in the notes to the financial statements is organised so that relationships to items reported on the face of the financial statements are clear. The notes are an integral part of the financial statements.

Principles for Organisation of Information within Other GPFRs

8.62 As is the case for the financial statements, information organization in other GPFRs helps to ensure that key messages conveyed by displayed information are understandable. Presentation that clearly identifies important relationships is likely to enhance the extent to which a report:

- Meets the objectives of financial reporting; and
- Achieves the qualitative characteristics.

8.63 Linking related information helps users to find important information. Some information is more understandable when organised into graphs, charts, tables, ratios or key performance indicators. Other information may be presented more effectively in narrative form. Information organisation supports users' understanding of linkages between information within the same GPFR.

8.64 Information organisation facilitates comparisons such as making clear when items are similar or dissimilar. Inter-period comparability is facilitated by avoiding changes to the way that information is organised for the same entity from year to year unless such changes enhance relevance and understandability. Inter-entity comparisons are facilitated when different reporting entities organise the information they present in similar ways.

Exposure Draft

Revised Accounting Standard for Local Bodies (ASLB) 17

Property, Plant and Equipment

Contents

Revised Accounting Standard for Local Bodies (ASLB) 17

Property, Plant and Equipment

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objectives and the Preface to the Accounting Standards for Local Bodies[1]).*

The Accounting Standard for Local Bodies (ASLB) 17, *'Property, Plant and Equipment'*, issued by the Council of the Institute of Chartered Accountants of India, will be recommendatory[2] in nature in the initial years for use by the local bodies. This Standard will be mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned[3].

The following is the text of the Accounting Standard for Local Bodies**.**

Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

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[1] Attention is specifically drawn to paragraph 4.2 of the '*Preface to the Accounting Standards for Local Bodies'*, according to which Accounting Standards are intended to apply only to items which are material.

[2] Till this standard is notified and made mandatory by the concerned State Government, it is recommended that Fixed Asset Register, as per format prescribed in the National Municipal Accounting Manual / State Municipal Accounting Manual, may be maintained.

[3] Reference may be made to the paragraph 7.1 of the '*Preface to the Accounting Standards for Local Bodies'* providing the discussion on the compliance with the Accounting Standards for Local Bodies.

Scope

2. An entity that prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for property, plant and equipment, except:

> ***(a) When a different accounting treatment has been adopted in accordance with another Accounting Standard for Local Bodies; and***
>
> ***(b) In respect of heritage assets. However, the disclosure requirements of paragraphs 88, 89 and 92 apply to those heritage assets that are recognised.***

3. This Standard applies to entities described as local bodies in the Preface to the Accounting Standards for Local Bodies[4].

4. This Standard applies to property, plant and equipment. The paragraphs 21 - 21 A provide guidance with regard to accounting and reporting of ~~including infrastructure~~ General Public Utility Assets held in trust by local bodies ~~assets~~[5].

5. This Standard does not apply to:

> (a) Biological assets, i.e., living animals or plants, related to agricultural activity;
>
> (b) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources; and
>
> (c) Natural resources like natural lakes.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in paragraphs 5(a) to 5(c).

6. Accounting Standards for Local Bodies may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, ASLB on *'Leases'*[6] requires an entity to evaluate its recognition of an item leased property, plant and equipment on the basis of

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[4] Refer paragraph 1.3 of the '*Preface to the Accounting Standards for Local Bodies*'.

[5] Assets under Service Concession Arrangements are not included. Separate pronouncement is under preparation.

[6] The Accounting Standard for Local Bodies is under preparation.

the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard. Guidance on accounting for leases can be found in Accounting Standard (AS) 19, *'Leases'* until the ASLB on this subject is formulated.

7. An entity should apply this Standard to property that is being constructed or developed for future use as investment property but does not yet satisfy the definition of 'investment property' in ASLB on *'Investment Property'*[7]. Once the construction or development is complete, the property becomes investment property and the entity is required to apply ASLB on *'Investment Property'*. ASLB on *'Investment Property'* also applies to investment property that is being redeveloped for continued future use as investment property. An entity using the cost model for investment property in accordance with ASLB on *'Investment Property'* should use the cost model in this Standard. Guidance on accounting for investment property can be found in Accounting Standard (AS) 13, *'Investments'* until the ASLB on this subject is formulated.

Heritage Assets[8]

8. This Standard does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognise heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.

9. Some assets are described as 'heritage assets' because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):

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[7] 'Investment Property is property (land or a building – or part of a building – or both) held to earn rentals or for capital appreciation or both, rather than for, use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of operations'. The Accounting Standard for Local Bodies on the subject is under preparation.

[8] The formulation of the ASLB on '*Heritage Assets*' is yet to be taken up.

(a) Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;

(b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

(c) They are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and

(d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years. Entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.

10. Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation or for commercial purposes. In these cases, they may be recognised and measured on the same basis as other items of property, plant and equipment. For other heritage assets, service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.

11. The disclosure requirements in paragraphs 88 to 94 require entities to make disclosures about recognised assets. Therefore, entities that recognise heritage assets are required to disclose in respect of those assets such matters as, for example:

(a) The measurement basis used;

(b) The depreciation method used, if any;

(c) The gross carrying amount;

(d) The accumulated depreciation at the end of the period, if any; and

(e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

12. [Refer to Appendix 1]

Definitions

13. The following terms are used in this Standard with the meanings specified:

<u>Carrying amount</u> (for the purpose of this Standard) is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses[9].

<u>Class of property, plant and equipment</u> means a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.

<u>Cost</u> is the amount of cash or cash equivalents paid and the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

<u>Depreciation</u> is the systematic allocation of the depreciable amount of an asset over its useful life.

<u>Depreciable amount</u> is the cost of an asset, or other amount substituted for cost, less its residual value.

<u>Fair value</u> is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

<u>Property, plant and equipment</u> are tangible items that:

(a) Are held for use in the production or supply of goods or

[9] Guidance on accounting for impairment losses on cash generating assets can be found in Accounting Standard (AS) 28, '*Impairment of Assets'* until the ASLB on this subject is formulated.

services, for rental to others, or for administrative purposes; and

(b) Are expected to be used during more than one reporting period.

The <u>residual value</u> of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

<u>Useful life</u> is:

(a) The period over which an asset is expected to be available for use by an entity; or

(b) The number of production or similar units expected to be obtained from the asset by an entity.

Terms defined in other Accounting Standards for Local Bodies are used in this Standard with the same meaning as in those other Standards.

Recognition

14. The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

(a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and

(b) The cost ~~or fair value~~ of the item can be measured reliably.

15-16. [Deleted]

17. Spare parts and servicing equipment are usually carried as inventory and recognised in the statement of income and expenditure as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in

connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.

18. This standard does not prescribe the unit of measure for recognition, i.e. what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as library books, computer peripherals and small items of equipment, and to apply the criteria to the aggregate value.

19. An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it[10].

20. [Refer to Appendix 1]

~~Infrastructure~~General Public Utility Assets held in trust by local bodies

21. Some assets are ~~commonly described as 'infrastructure assets'~~hold by the local bodies solely for the use of General Public . While there is no universally accepted definition of ~~infrastructure~~ General Public Utility assets, these assets usually display some or all of the following characteristics:

(a) They are part of a system or network;
(b) They are specialised in nature and do not have alternative uses;
(c) They are immovable; and
(d) They may be subject to constraints on disposal.

~~Although ownership of infrastructure assets is not confined to Local Bodies~~, ~~significant~~ Examples of ~~infrastructure~~such assets, are road networks, sewer systems, water and power supply systems etc., which are frequently found in the Local Bodies. Although, ~~Infrastructure~~ these assets may meet the definition of property, plant and equipment ~~and~~ . In some cases, the ownership of such assets is also not confined to local bodies but the same are held by these entities under trust to perform certain functions as entrusted to them i.e. to preserve and maintain the same. Accordingly, these should be accounted and reported differently. Paragraph 21A prescribes the accounting treatment for such assets. ~~for in accordance with this Standard~~. ~~Examples of infrastructure assets include road~~

[10] See paragraph 25

~~networks, sewer systems, water and power supply systems and communication networks~~.

21 A All expenditure incurred with respect to General Public Utility assets should be expensed off in the period incurred and these are not required to be depreciated. However, such assets should be manged and preserved according to the condition level[11] established and disclosed by the government in this regard. To help users to assess the degree to which these assets are being maintained and preserved, the entities should:

- Keep an up-to date inventory of General Public Utility assets.
- Estimate each year the annual amount required to maintain and preserve such assets at the prescribed condition level.
- Meet the disclosure requirements prescribed in paragraph 93 a.

Initial Costs

22. Items of property, plant and equipment may be required for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits or service potential of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits or service potential from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits or service potential from related assets in excess of what could be derived had those items not been acquired. For example, fire safety regulations may require a hospital to acquire new sprinkler systems. These enhancements are recognised as an asset because without them the entity is unable to operate the hospital in accordance with the regulations.

Subsequent Costs

23. Under the recognition principle in paragraph 14, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the statement of income and expenditure as incurred. Costs of day-to-day servicing are primarily the costs of labor and consumables, and may include the

[11] The condition level may be established by administrative or executive policy or relevant legislation.

cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

24. Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a road may need resurfacing every few years, or a furnace may require relining after a specified number of hours of use. Items of property, plant and equipment may also be required to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 17, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 82 to 87).

25. A condition of continuing to operate an item of property, plant and equipment (for example, a water treatment plant) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at Recognition

26. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its ~~cost.~~

27. Where an asset is acquired at nil or nominal consideration, its cost should be measured at ~~its fair value~~ nominal value of Re. 1 ~~as at the date of acquisition~~.

28. An item of property, plant and equipment may be acquired at nil or nominal consideration. For example, land may be contributed/ transferred to a

Local Body by a State Government or a Government agency or a developer at no or nominal consideration, to enable the Local Body to develop parks, roads and paths in the development. An asset may also be acquired at nil or nominal consideration by the exercise of powers of acquisition. Under these circumstances the cost of the item is ~~its fair value~~ nominal value i.e. Re 1 ~~as at the date it is acquired~~.

29. For the purposes of this Standard, the measurement at recognition of an item of property, plant and equipment, acquired at no or nominal cost, at ~~its fair value~~nominal value of Re.1 consistent with the requirements of paragraph 27, ~~does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 44, and the supporting commentary in paragraphs 45 to 50, only apply where an entity elects to revalue an item of property, plant and equipment in subsequent reporting periods~~.

Elements of Cost

30. The cost of an item of property, plant and equipment comprises:

(a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

31. Examples of directly attributable costs are:

(a) Costs of employee benefits[12] arising directly from the construction or acquisition of the item of property, plant and equipment;

[12] Guidance on accounting for employee benefits can be found in AS 15 (Revised 2005) until the ASLB on this subject is formulated.

(b) Costs of site preparation;

(c) Initial delivery and handling costs;

(d) Installation and assembly costs;

(e) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) Professional fees.

32. An entity applies ASLB 12, *'Inventories'*, to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with ASLB 12, *'Inventories'* and this Standard are recognised and measured in accordance with ASLB 19, *'Provisions, Contingent Liabilities and Contingent Assets*'.

33. Examples of costs that are not costs of an item of property, plant and equipment are:

(a) Costs of opening a new facility;

(b) Costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) Costs of providing service in a new location or with a new class of users (including costs of staff training); and

(d) Administration and other general overhead costs.

34. Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) Initial operating losses, such as those incurred while demand for the item's output builds up; and

(c) Costs of relocating or reorganising part or all of the entity's operations.

35. Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, revenue may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognised in the statement of income and expenditure, and included in their respective classifications of income and expense.

36. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of operations, the cost of the asset is usually the same as the cost of constructing an asset for sale (see ASLB 12, *'Inventories'*). Therefore, any internal surpluses are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labor, or other resources incurred in self-constructing an asset is not included in the cost of the asset. ASLB 5, *'Borrowing Costs'*, establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

Measurement of cost

37. The cost of an item of property, plant and equipment is the cash price equivalent ~~or, for an item referred to in paragraph 27, its fair value~~ at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of any item in accordance with ASLB 5, *'Borrowing Costs'*.

38. One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The cost of such an item of property, plant and equipment is measured at the fair value of the consideration given. It may be appropriate to consider also the fair value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the assets given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

39-40.[Refer to Appendix 1]

41. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with ASLB on *'Leases'*. Guidance on accounting for 'Leases' can be found in Accounting Standard (AS) 19, *'Leases'*, until the ASLB on this subject is formulated.

Measurement after Recognition

42. An entity should choose either the cost model in paragraph 43 or the revaluation model in paragraph 44 as its accounting policy and should apply that policy to an entire class of property, plant and equipment.

Cost Model

43. After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation Model

44. After recognition as an asset, an item of property, plant and equipment except those referred in paragraph 27, whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. The accounting treatment for revaluations is set out in paragraphs 53 to 55.

45. The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal in a manner set out in the Appendix by a person holding a recognised and relevant professional qualification for valuation. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, non-specialised buildings, motor vehicles and many types of plant and equipment.

46. For some assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some entities may have significant holdings of such assets. Guidelines for determination of fair value of such assets are given in Appendix.

47-48.[Refer to Appendix 1]

49. The frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

50. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:

(a) Restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to its depreciated replacement cost.

(b) Eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 54 and 55.

51. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.

52. A class of property, plant and equipment is a grouping of assets of a similar nature or function in an entity's operations. The following are examples of separate classes:

(a) Land;

(b) Parks and Play Grounds;

(c) Buildings;

(i) Commercial buildings such as office complexes, markets; and

(ii) Non–commercial buildings such as administrative buildings, community centers, schools, health centers;

(d) ~~Roads~~;

(e) Machinery;

(f) ~~Electricity transmission networks~~;

(g) ~~Pipelines~~;

(h) ~~Drains~~;

(i) ~~Bridges~~;

(j) Motor vehicles;

(k) Furniture and fixtures;

(l) Office equipment; and

(m) Heritage assets.

53. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis

provided revaluation of the class of assets is completed within a short period say the relevant financial year and provided the revaluations are kept up to date.

54. If the carrying amount of a class of assets is increased as a result of a revaluation, the increase should be credited directly to revaluation surplus. However, the increase should be recognised in the statement of income and expenditure to the extent that it reverses a revaluation decrease of the same class of assets previously recognised in statement of income and expenditure.

55. If the carrying amount of a class of assets is decreased as a result of a revaluation, the decrease should be recognised in statement of income and expenditure. However, the decrease should be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.

56. Revaluation increases and decreases relating to individual assets within a class of property, plant and equipment must be offset against one another within that class but must not be offset in respect of assets in different classes.

57. Some or all of the revaluation surplus included in net assets/equity in respect of property, plant and equipment may be transferred directly to accumulated surpluses or deficits when the assets are derecognised. This may involve transferring some or the whole of the surplus when the assets within the class of property, plant and equipment to which the surplus relates are retired or disposed of. However, some of the surplus may be transferred as the assets are used by the entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets' original cost. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through statement of income and expenditure.

58. [Refer to Appendix 1]

Depreciation

59. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.

60. An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges and lighting within a road system.

61. A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

62. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

63. An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

64. The depreciation charge for each period should be recognised in the statement of income and expenditure unless it is included in the carrying amount of another asset.

65. The depreciation charge for a period is usually recognised in statement of income and expenditure. However, sometimes, the future economic benefits or service potential embodied in an asset is absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of a concrete mixer used in the construction of a building is included in the cost of the building.

Depreciation Amount and Depreciation Period

66. The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

67. The residual value and the useful life of an asset should be reviewed at least at each annual reporting date and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in

an accounting estimate in accordance with ASLB 3, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

68. Depreciation is recognised even if the fair value of the assets exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset does not negate the need to depreciate it. Conversely, some assets may be poorly maintained or maintenance may be deferred indefinitely because of budgetary constraints. Where asset management policies exacerbate the wear and tear of an asset, its useful life should be reassessed and adjusted accordingly.

69. The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.

70. The residual value of an asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

71. Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

72. The future economic benefits or service potential embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits or service potential that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) Expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

(d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

73. The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of an entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits or service potential embodied in the asset. Therefore, the useful life of asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets.

74. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

75. If the cost of land includes the cost of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits or service potential obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits or service potential to be derived from it.

Depreciation Method

76. The depreciation method should reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity.

77. The depreciation method applied to an asset should be reviewed at least at each annual reporting date and, if there has been a significant change in the expected pattern of the consumption of the future economic benefits or service potential embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with ASLB 3, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

78. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits or service potential embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

79. [Refer to Appendix 1]

Compensation for impairment or losses

80. Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in statement of income and expenditure when the compensation becomes receivable.

81. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

(a) Impairments or losses of items of property, plant and equipment are recognised;

(b) Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;

(c) Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining surplus or deficit when it becomes receivable; and

(d) The cost of items of property, plant and equipment restored, purchased or constructed as replacement determined in accordance with this Standard.

Derecognition

82. The carrying amount of an item of property, plant and equipment should be derecognised:

(a) On disposal; or

(b) When no future economic benefits or service potential is expected from its use or disposal.

83. The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of income and expenditure when the item is derecognised (unless ASLB on 'Leases' requires otherwise on a sale and leaseback). Gains should not be classified as revenue.

84. The disposal of an item of property, plant and equipment may occur in a variety ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in ASLB 9, *'Revenue from Exchange Transactions'* for recognising revenue from the sale of goods. ASLB on *'Leases'* applies to disposal by a sale and leaseback.

85. If, under the recognition principle in paragraph 14, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

86. The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

87. The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value. If payment for the item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with ASLB 9 reflecting the effective yield on the receivable.

Disclosure

88. The financial statements should disclose, for each class of property, plant and equipment recognised in the financial statements:

- ***(a) The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;***
- ***(b) The depreciation methods used;***
- ***(c) The useful lives or the depreciation rates used;***
- ***(d) The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and***
- ***(e) A reconciliation of the carrying amount at the beginning and end of the period showing:***
  - ***(i) Additions;***
  - ***(ii) Disposals;***
  - ***(iii) Acquisitions through entity combinations;***
  - ***(iv) Increases or resulting from revaluations under paragraphs 44, 54 and 55 and from impairment losses (if any) recognised or reversed directly in net assets/equity;***
  - ***(v) Impairment losses recognised in the statement of income and expenditure;***

(vi) Impairment losses reversed in the statement of income and expenditure;

(vii) Depreciation; and

(viii) other changes.

89. The financial statements should also disclose for each class of property, plant and equipment recognised in the financial statements:

(a) The existence and amounts of restrictions on title, and property, plant and equipment pledged as securities for liabilities;

(b) The amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) The amount of contractual commitments for the acquisition of property, plant and equipment; and

(d) If it is not disclosed separately on the face of the statement of income and expenditure, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of income and expenditure.

90. Selection of the depreciation method and the estimation of the useful life of the assets are matters of judgment. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:

(a) Depreciation, whether recognised in the statement of income and expenditure or as a part of the cost of other assets, during a period; and

(b) Accumulated depreciation at the end of the period.

91. In accordance with ASLB 3, *'Accounting Policies, Changes in Accounting Estimates and Errors'* an entity discloses nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:

(a) Residual values;

(b) The estimated costs of dismantling, removing or restoring items of property, plant and equipment;

(c) Useful lives; and

(d) Depreciation methods.

92. If a class of property, plant and equipment is stated at revalued amounts, the following should be disclosed:

(a) The effective date of the revaluation;

(b) Whether an independent valuer was involved;

(c) The methods and significant assumptions applied in estimating the assets' fair values;

(d) The extent to which the assets' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques;

(e) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to owners;

(f) The sum of all revaluation surpluses for individual items of property, plant and equipment within that class; and

(g) The sum of all revaluation deficits for individual items of property, plant and equipment within that class.

93. [Refer to Appendix 1]

93 A The entity should disclose in notes to financial statements, all General Public Utility assets managed and preserved by it, that are accounted for in accordance with paragraph 21 - 21 A along with the amount spent to preserve and maintain the same at the prescribed condition level.

94. Users of financial statements may also find the following information relevant to their needs:

(a) The carrying amount of temporarily idle property, plant and equipment;

(b) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use;

(c) The carrying amount of property, plant and equipment retired from active use and held for disposal; and

(d) When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional Provisions

95. [Refer to Appendix 1]

96. An entity that adopts accrual accounting for the first time in accordance with Accounting Standards for Local Bodies should initially recognise property, plant and equipment at cost or ~~fair value~~nominal value in accordance with this Standard. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the ~~item's fair value~~nominal value of Re 1~~ as at the date of acquisition~~. The same principle will apply for items of property, plant and equipment which exists at the time when accrual accounting is adopted for the first time but recognised in subsequent years after the adoption of accrual accounting for the first time.

97. The entity should recognise the effect of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognised.

98. Prior to first application of this Standard, an entity may recognise its property, plant and equipment on a basis other than cost or fair value as defined in this Standard, or may control assets that it has not recognised. This Standard requires entities to initially recognise items of property, plant and equipment at cost ~~or, fair value as at the date of initial recognition~~ in accordance with this Standard. Where assets ~~are initially recognised at cost and~~ were acquired at no cost, or for a nominal cost, cost will be nominal value of Re 1.~~determined by reference to the asset's fair value as at the date of acquisition. Where the cost of acquisition of an asset is not known, its cost may be estimated by reference to its fair value as at the date of acquisition~~.

99. When an entity initially recognises an item of property, plant and equipment at cost in accordance with this Standard, it should also recognise any accumulated depreciation and any accumulated impairment losses that relate to that item, as if it had always applied those accounting policies.

100-103. [Refer to Appendix 1]

104. When an entity takes advantage of the transitional provisions in paragraphs 96 that fact should be disclosed. When an entity takes

advantage of the transitional provisions for a second or subsequent reporting period, details of the assets or classes of asset that were not recognised at the previous reporting date but that are now recognised should be disclosed.

105-106. [Refer to Appendix 1]

107-109. [Refer to Appendix 1]

Appendix A

Implementation Guidance 1 – Determination of Fair Value of Property, Plant and Equipment by Appraisal

This guidance accompanies, but not a part of, ASLB 17.

1. If no evidence is available to determine the market value in an active and liquid market of an item of property, plant and equipment, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available. In the case of specialised buildings and other man made structures, fair value may be determined by a valuer using depreciated replacement cost, or the restoration cost or service units approaches. In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a building belongs to a Local Body may be reproduced rather than replaced with alternative accommodation because of its significance to the community.

2. If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment, an entity may need to estimate fair value using, for example, reproduction cost, depreciated replacement cost, or the restoration cost or service units approaches. The depreciated replacement cost of an item of property, plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. When the indexed price method is used, judgment is required to determine whether production technology has changed significantly over the period, and whether the capacity of the reference asset is the same as that of the asset being valued.

Implementation Guidance 2 – Frequency of Revaluation of Property, Plant and Equipment

This guidance accompanies, but is not part of, ASLB 17.

1. Paragraph 44 of ASLB 17 requires entities that adopt the revaluation model to measure its assets at a revaluated amount does not differ significantly from that which would be determined using fair value at the reporting date. Paragraph 49 of ASLB 17 specifies that the frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. The purpose of this guidance is to assist entities that adopt the revaluation model to determine whether carrying amounts differ materially from the fair value as at reporting date.

2. An entity assesses at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the entity determines the asset's fair value and revalues the asset to that amount.

3. In assessing whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date, an entity considers, as a minimum, the following indications:

External sources of information

(a) Significant changes affecting the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;

(b) Where market exists for the assets of the entity, market values are different from their carrying amounts;

(c) During the period, a price index relevant to the asset has undergone
a material change;

Internal sources of information

(d) Evidence is available of obsolescence or physical damage of an asset;

(e) Significant changes affecting the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. Adverse changes include the asset becoming idle, or plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. Favourable changes include capital expenditure incurred during the period to improve or enhance an asset in excess of its standard of performance assessed immediately before the expenditure is made; and

(f) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse or better than expected.

4. The list in paragraph 3 is not exhaustive. An entity may identify other indications that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. The existence of these additional indicators would also indicate that the entity should revalue the asset to its current fair value as at the reporting date.

Implementation Guidance 3 – Illustrative Disclosures

Examples

This guidance accompanies, but is not part of, ASLB 17.

A Local Body controls a wide range of property, plant and equipment and is responsible for replacement and maintenance of the property. The following are extracts from the notes to its Balance Sheet as at 31 March 20X1 and illustrate the principal disclosures required in accordance with this Standard.

Notes

1. Land

(a) Land consists of five thousand hectares at various locations. Land is valued at fair value as at 31 March 20X1, as determined by an authorised independent valuer.

(b) Restrictions on Titles:

Five hundred hectares of land (carried at Rs 62 lakh) is designated as public interest land and may not be sold without the approval of the state legislature. Two hundred hectares (carried at Rs 25 lakh) of the public interest land and a further two thousand hectares (carried at Rs. 250 lakh) of other land are subject to title claims by former owners in jurisdictional High Court and the Court has ordered that the land may not be disposed of until the claim is decided; the Local Body recognises the jurisdiction of the Court to hear these cases.

2. Buildings

(a) Buildings consist of administrative buildings and commercial buildings at various locations.

(b) Buildings are initially recognised at cost, but are subject to revaluation to fair value on an ongoing basis. An authorised valuer from a panel of recognised valuers determines fair value. All revaluations within a class of assets is completed within the financial year. Revaluations are kept up to date.

(c) Depreciation is calculated on a straight-line basis over the useful life of the building. Administrative buildings have a useful life of twenty-five years, and commercial buildings have a useful life of fifteen years.

(d) The Local Body has entered into five contracts for the construction of new buildings; total contract costs are Rs. 250 lakh.

3. **Machinery**

(a) Machinery is measured at cost less depreciation.

(b) Depreciation is calculated on a straight-line basis over the useful life of the machine.

(c) The machinery has various useful lives:
Tractors: 20 years
Concrete Mixer: 14 years

Cranes: 15 years

(d) The Local Body has entered into a contract to replace the cranes it uses to clean and maintain the buildings – the contracted cost is Rs. 100 lakh.

4. **Furniture and Fixtures**

(a) Furniture and fixtures are measured at cost less depreciation.

(b) Depreciation is calculated on a straight-line basis over the useful life of the furniture and fixtures.

(c) All items within this class have a useful life of seven years.

~~5. **Infrastructure Assets**~~

~~(a) Infrastructure assets are shown at cost less depreciation.~~

~~(b) Useful lives of various categories of infrastructure assets:~~
~~Flyovers: 25years~~
~~Water supply net work: 30 years~~

~~Storm water drains: 25 years~~

Reconciliations

(Amount in Rs. Lakh)

	Gross Block					Depreciation				Net Block	
	Opening balance	Additions during the year	Disposals	Revaluations (net)	Closing balance	Opening balance	Depreciation during the year	Depreciation written back	Closing balance	At the end of the year	At the beginning of the year
Land	25,000	1,500	100	1,000	27,400	19,150	2,397	12	21,535	5,865	5,850
Buildings	10,000	600		200	10,800	5,850	475	-	6,325	4,475	4,150
Plant & Machinery	3,000	150	25	-	3,125	1,250	103	3	1,350	1,775	1,750
~~Infrastructure assets~~	~~65,000~~	~~15,000~~	~~-~~	~~(1,500)~~	~~78,500~~	~~44,500~~	~~1,425~~	~~-~~	~~45,925~~	~~32,575~~	~~20,500~~
Vehicles	150	50	-	-	200	25	20	-	45	155	125
Office equipments	250	30	-	-	280	52	13	-	65	215	198
Other assets	7,500	150	100		7,550	4,500	295	45	4,750	2,800	3,000
Total	1,10,900	17,480	225	(300)	1,27,855	75,327	4,728	60	79,995	47,860	35,573

Appendix 1

Note: This Appendix is not a part of the Accounting Standard for Local bodies. The purpose of this appendix is only to bring out the major differences between this Accounting Standard for Local Bodies (ASLB) and the corresponding International Public Sector Accounting Standard (IPSAS) 17, 'Property, Plant and Equipment'.

Comparison with IPSAS 17, '*Property, Plant and Equipment'*

Definition

1. IPSAS 17 defines the terms 'Entity Specific Value', 'Exchange Transactions', 'Non- exchange Transactions', 'Impairment Loss of Cash Generating Assets', 'Impairment Loss of Non-cash Generating Assets', 'Recoverable Amount' and 'Recoverable Service Amount'. ASLB 17, *'Property, Plant and Equipment'* does not define these terms for the reasons given below:

(a) 'Entity Specific Value': This term is defined in the context of determining commercial substance of an exchange transaction. The concept of commercial substance is not used in ASLB 17 for measuring fair value of assets acquired in exchange for a non-monetary asset(s) with a view to simplify the requirements in this regard as the accrual accounting in Local Bodies in India is at its inception stage.

(b) 'Exchange Transactions' and 'Non-exchange Transactions': For accounting for items of property, plant and equipment acquired without incurring any obligation, ASLB 17 uses the terms 'Nil' and 'nominal consideration' in paragraph 27 in place of the term 'non-exchange transactions'. Accordingly, neither the term 'Non-exchange Transactions' nor the term 'Exchange Transactions' has been used. The aforesaid terms are not used because, these have different connotations in the ASLB 9, *'Revenue from Exchange Transactions'*.

(c) 'Impairment Loss of Non-cash Generating Assets' and 'Recoverable Service Amount': The concept of impairment loss of non-cash generating assets has not been dealt with keeping in view the complexities involved in its application at the very early stage of adoption of accrual basis of accounting in Local Bodies in India.

(d) 'Impairment Loss of Cash Generating Assets' and 'Recoverable Amount': Since, at present, there is no ASLB on the above subject and reference has been made for guidance to Accounting Standard (AS) 28, *'Impairment of Assets',* till formulation of ASLB on this subject, these terms have not been defined in ASLB 17.

Measurement of Cost

2. IPSAS 17 requires to measure a property, plant and equipment acquired in exchange for non-monetary asset(s) or combination of non-monetary asset(s) at fair value unless the exchange transaction lacks commercial substance or the fair value of neither assets received nor the assets given up is reliably measurable. IPSAS 17 gives detailed guidance on when an exchange transaction has commercial substance. Under the ASLB 17, *'Property, Plant and Equipment',* an entity measures such acquired assets at fair value. The standard recognises an alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, to record the asset acquired at the net book value of the assets given up.

Since the Local Bodies are at early stage of adoption of accrual basis of accounting, it would be difficult for Local Bodies to apply the complexity of determining the exchange transactions that have commercial substance.

3. The draft provides a different accounting treatment for general public utility assets that are held by the local bodies in trust for the purpose of the maintenance with a requirement of keeping a record of the same.

4. The draft prescribes to value assets acquired at nil or nominal consideration at Re.1 instead of fair value as prescribed in IPSAS.

Transitional Provisions

~~3~~4. IPSAS 17 contains a transitional provision providing relief from the requirement to recognise all property, plant and equipment for five years following the date of first adoption of accrual accounting. ASLB 17 does not provide for the same. However, on the lines of other ASLBs, ASLB 17 also requires in the introductory paragraph that the Standard will be recommendatory in nature in initial years for use by local bodies and mandatory for local bodies in a State from the date specified in this regard by the State Government concerned.

Terminology

4. ASLB 17 uses different terminology, in certain instances, from IPSAS 17. For example, the use of the term ‘statement of income and expenditure’ in ASLB 17. The equivalent terms in IPSAS 17 are ‘surplus or deficit’ and/or ‘statement of financial performance’, because in India, the Local Bodies do not, at present, use these terms.

Paragraphs Deleted

5. As a consequence of the above changes, following paragraphs have been deleted. However, their numbers have been retained in order to maintain consistency with corresponding IPSAS.

Paragraph 12 : Deleted as it pertains to Government Business Enterprises (GBEs).

Paragraph 20 : Not relevant for Local Bodies as it pertains to military equipments.

Paragraphs 39, 40, 47 & 48 : Deleted as a consequence of modification in ASLB 17 mentioned at point no. (2) in respect of measurement of cost.

Paragraphs 58 : Refer to Standard on ‘Taxes’. Since there is no ASLB on the subject, the paragraph has been deleted.

Paragraphs 79 & 93 : Paragraphs refering to treatments provided under IPSAS on “Impairment of Cash Generating Assets" have been deleted as there is no ASLB on the said subject at present.

Paragraphs 95, 100, 101, 102, 103, 105 & 106 : Deleted as a consequence of modification mentioned at point no. (3) above relating to transitional provisions.

Paragraphs 107 to 108 : Paragraphs pertaining to effective date have been deleted as the ASLBs would become mandatory for Local Bodies in a State from the date specified by the State Government concerned.