

6 Tangible non-current assets

Chapter 6 Contents

6.1	Introduction.....	1
6.2	Accounting standards.....	1
	IAS 16 Property, Plant and Equipment.....	1
	<i>Applicability</i>	1
	<i>Objectives of IAS 16</i>	2
	<i>Adaptation of IAS 16 for the public sector context</i>	2
	<i>Interpretations of IAS 16 for the public sector context</i>	2
	Valuations	3
	<i>Property</i>	3
	<i>Non-property (excluding infrastructure assets, donated assets and heritage assets)</i>	4
	<i>Other requirements</i>	4
	Infrastructure assets	5
	<i>Additional guidance in respect of the road network</i>	5
	Donated assets	6
	Asset transfers.....	7
	Heritage assets	7
	<i>Interpretation of IAS 16 in respect of accounting for heritage assets</i>	7
	IAS 17 Leases, SIC 15 Operating Leases – Incentives, SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease, IFRIC 4 Determining whether an Arrangement contains a Lease, and IFRIC 12 Service Concession Arrangements	9
	<i>Applicability</i>	9
	<i>Objectives of IAS 17</i>	9
	<i>SIC 15 consensus</i>	9
	<i>SIC 27 consensus</i>	9
	<i>IFRIC 4 consensus</i>	9
	Accounting for PPP arrangements, including PFI contracts, under IFRS.....	10
	<i>Scope</i>	10
	<i>Initial recognition and measurement of assets and liabilities in new arrangements and contracts</i>	12
	<i>Initial recognition of existing arrangements which were off-balance sheet under UK GAAP</i>	14
	<i>Subsequent measurement</i>	14
	<i>Income generated by the grantor from the service concession arrangements</i>	14
	<i>Consideration given by the grantor to the operator (guarantees made by the grantor as part of the arrangement)</i>	14
	<i>Items provided to the operator by the grantor</i>	15
	<i>Disclosure</i>	15
	IAS 20 Accounting for Government Grants and Disclosure of Government Assistance and SIC 10 Government Assistance – No Specific Relation to Operating Activities.....	15
	<i>Applicability</i>	15
	<i>Objective of IAS 20</i>	15

<i>SIC 10 consensus</i>	15
<i>Interpretation of IAS 20 and SIC 10 for the public sector context</i>	15
<i>Other requirements</i>	15
<i>Summary of accounting treatment</i>	16
IAS 23 Borrowing Costs	16
<i>Applicability</i>	16
<i>Objective of IAS 23</i>	16
<i>Interpretation of IAS 23 for the public sector context</i>	17
IAS 40 Investment Properties.....	17
<i>Applicability</i>	17
<i>Objectives of IAS 40</i>	17
<i>Interpretation of IAS 40 for the public sector context</i>	17
IAS 41 Agriculture.....	17
<i>Applicability</i>	17
<i>Objectives of IAS 41</i>	17
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.....	18
<i>Applicability</i>	18
<i>Objectives of IFRS 5</i>	18
<i>Interpretation of IFRS 5 for the public sector context</i>	18

6.1 Introduction

- 6.1.1 This chapter identifies the accounting standards, their adaptations, interpretation and other requirements and guidance relating to tangible assets, that reporting entities and reportable activities should apply when preparing their statements of financial position. The chapter looks at each of the relevant accounting standards and, where appropriate, gives a link to a worked example of how the principles should be applied. Chapter 5 provides more detail on the disclosure requirements.

6.2 Accounting standards

- 6.2.1 The following accounting standards and UITF Abstracts deal with accounting for tangible fixed assets:
- IAS 16 *Property, Plant and Equipment*;
 - IAS 17 *Leases*;
 - SIC 15 *Operating Leases – Incentives*;
 - SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*;
 - IFRIC 4 *Determining whether an arrangement contains a lease*;
 - IFRIC 12 *Service Concession Arrangements*;
 - IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*;
 - SIC 10 *Government Assistance – No Specific Relation to Operating Activities*;
 - IAS 23 *Borrowing Costs*;
 - IAS 40 *Investment Properties*;
 - IAS 41 *Agriculture*; and
 - IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

IAS 16 Property, Plant and Equipment

Applicability

- 6.2.2 IAS 16 applies, as adapted in paragraph 6.2.5, to all reporting entities covered by this Manual. Owing to their importance to the entities covered by the requirements of this Manual, separate guidance is included on:
- infrastructure assets (paragraphs 6.2.10 to 6.2.18);
 - donated assets (paragraphs 6.2.19 to 6.2.23);
 - asset transfers (paragraph 6.2.24); and
 - heritage assets (paragraphs 6.2.25 to 6.2.29).
- 6.2.3 A worked example of accounting for a fixed asset using modified historical cost accounting is provided on this Manual's dedicated website.

Objectives of IAS 16

- 6.2.4 The objective of IAS 16 is to prescribe the accounting treatment for property, plant and equipment so that users of the 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 assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Adaptation of IAS 16 for the public sector context

- 6.2.5 For 'in use' non-specialised property assets fair value should be interpreted as market value for existing use. In the RICS Red Book, this is defined as 'market value on the assumption that property is sold as part of the continuing enterprise in occupation'. This manual provides further guidance on the valuation of property assets at 6.2.8.
- 6.2.6 The following general adaptations to IAS 16 apply to reporting entities required to prepare their financial statements in accordance with the guidance in this Manual.

Measurement

Gains on revaluation of fixed assets should be credited to the relevant reserve as follows:

- Assets financed by grants in aid – the revaluation reserve (5.4.55)
- Donated assets – the donated asset reserve (5.4.56)
- Assets financed by grants, including any from the EU– the government grant reserve (5.4.57)

Losses on revaluation should be debited to the relevant reserve (see above) to the extent that gains have been recorded previously, and otherwise to the operating cost statement.

Interpretations of IAS 16 for the public sector context

- 6.2.7 In applying IAS 16, reporting entities should be aware of the following interpretations for the public sector context.

Recognition and measurement

- a) All tangible fixed assets shall be carried at valuation at the reporting period – that is, the option given in IAS 16 to measure at cost has been withdrawn, as has the option to value only certain classes of assets.
- b) It is not necessary to disclose the historical cost carrying amounts (where available) as required by IAS 16.
- c) In considering the treatment of any interest at initial recognition, entities shall not capitalise any cost of capital charge associated with the item of property, plant or machinery.
- d) The 'value in use' of a non-cash-generating asset is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.

Valuations

- 6.2.8 In considering how best to apply the valuation requirements of IAS 16 so as to ensure that the statement of financial position gives a true and fair view of the value of the assets at the reporting period, entities should consider the following guidance on property and non-property assets. (More detailed guidance is available on the Manual's dedicated website.)

Property

Recognition and measurement

- a) Entities should value their property using the most appropriate valuation methodology. Such methods might include:
 - a quinquennial valuation supplemented by annual indexation and no interim professional valuation;
 - annual valuations; or
 - a rolling programme of valuations of properties (whether specialised or non-specialised).
- b) It is for valuers, using the Royal Institution of Chartered Surveyors; (RICS) 'Red Book' (RICS Appraisal and Valuation Standards), and following discussions with the entity, to determine the most appropriate methodology for obtaining a fair value. Where a valuer, following discussion with the entity, determined that depreciated replacement cost (DRC) is the most appropriate, entities and their valuers should have regard to the RICS Valuation Information Paper No. 10 *The depreciated replacement cost (DRC) method of valuation for Financial Statements*¹ as supplemented by the more detailed guidance available on this Manual's dedicated website.
- c) Where DRC is used as the valuation methodology, entities should normally value a modern equivalent asset in line with the Red Book. Any plans to value a reproduction of the existing asset instead should be discussed with the relevant authority (through sponsoring bodies where appropriate) to determine whether such an approach is appropriate to the entity's circumstances.
- d) Where DRC is used as the valuation methodology, entities should use the 'instant build' approach;
- e) Where DRC is used as the valuation methodology, the choice of an alternative site will normally hinge on the policy in respect of the locational requirements of the service that is being provided;
- f) The cost of enhancements to existing assets (such as building of a new wing within an existing prison or adding a lane to a motorway) should be capitalised during the construction phase as an asset under construction. At the first valuation after the asset is brought into use, any write down of cost should be treated as an impairment and charged to the operating cost statement.

¹ Contact the Royal Institution of Chartered Surveyors, 12 Great George Street, Parliament Square, London SW1P 3AD to obtain a copy of VIP 10.

Disclosure

- g) Entities should:
- disclose in the accounting policies note the fact that assets are carried at fair value. Entities should also provide information about the approach to valuing their estates, including a statement (where applicable) that alternative sites have been used in DRC valuations;
 - disclose in the notes on tangible fixed assets: the date of the last valuations of those property assets that are subject to revaluation, and the names and qualifications of the valuer; and
 - discuss in the Management Commentary, where they hold extensive estates: their estate management strategy; the indicative alternative use values provided by the valuer as part of the routine valuation work, and what those alternative use values mean in terms of their estate management policy.

Non-property (excluding infrastructure assets, donated assets and heritage assets)

Recognition and measurement

- h) Entities may elect to adopt a depreciated historical cost basis as a proxy for fair value for assets that have short useful lives or low values (or both). For depreciated historical cost to be considered as a proxy for fair value, the useful life must be a realistic reflection of the life of the asset and the depreciation method used must provide a realistic reflection of the consumption of that asset class.
- i) Assets that are not covered by the above paragraph should be carried at fair value. Entities should value such assets using the most appropriate valuation methodology available (for example, appropriate indices).

Disclosure

- j) Entities should disclose the following in the notes to their accounts in relation to the valuation of non-property assets:
- in the accounting policies note: the fact that assets are carried at fair value; that depreciated historical cost is used as a proxy for fair value for named classes of assets (where appropriate) and the reasons why; information about any significant estimation techniques (where applicable);
 - in the notes on tangible fixed assets: the dates of the last valuations of any non-property assets that are subject to revaluation and the names and qualifications of the valuer.

Other requirements

6.2.9 The following requirements should be observed by entities covered by this Manual.

- a) Following the annual review of the useful lives of assets or asset categories required by IAS 16, entities should discuss any significant proposals to change these lives with the relevant authorities (through sponsoring bodies where

- appropriate) to ensure that the budgeting implications have been properly considered.
- b) Entities might from time to time review their capitalisation thresholds or asset measurement methods. Any proposals for significant change to either must be discussed with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered.
- c) Entities should analyse their holdings of property, plant and equipment in accordance with 5.4.41.

Infrastructure assets

6.2.10 Infrastructure assets comprise assets that form part of an integrated network servicing a significant geographical area. These assets usually display some or all of the following characteristics:

- they are part of a system or network;
- they are specialised in nature and do not have alternative uses;
- they are immovable; and
- they may be subject to constraints on disposal.

Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communications networks.

Additional guidance in respect of the road network

Land, Structures and Communications

6.2.11 Land, Structures and Communications will be accounted for following the guidance in IAS 16.

Road Surface

6.2.12 The road surface asset managed by each of the highways authorities in England, Scotland, Wales and Northern Ireland will be recognised as a single asset by each such authority following the additional guidance in this manual.

6.2.13 The road surface asset will be held at depreciated replacement cost based on service potential.

6.2.14 Subsequent expenditure on the road surface will be capitalised where it enhances or replaces the service potential. Spending that does not replace or enhance service potential will be expensed.

6.2.15 The annual depreciation charge for the road surface will be the value of the service potential replaced through the maintenance programme plus, or minus, any adjustment resulting from the annual condition survey. The value of maintenance work undertaken will be used as an indication of the value of the replaced part. Where the condition survey shows that deterioration in the road surface exceeds the service potential replaced by the maintenance programme the additional deterioration will be taken to the OCS as part of the depreciation charge. Where the condition survey shows that deterioration in the road surface is less than the service potential

replaced by the maintenance programme the depreciation charge will be reduced by the excess maintenance.

- 6.2.16 The road surface will be subject to annual valuations as measured by suitable indices. Upward movements in value will be taken to the revaluation reserve. Downward movements in value will be set against any credit balance held in the revaluation reserve until this credit is exhausted and thereafter to the Operating Cost Statement.
- 6.2.17 The road surface will be subject to an annual impairment review. Impairments will be recognised as required by IAS 36 Impairment of Assets.

Other Infrastructure

- 6.2.18 Where Bodies hold other infrastructure assets the road surface accounting methodology detailed above may be used where it is appropriate to do so. However approval to use the road surface methodology should first be obtained from the relevant authority.

Donated assets

- 6.2.19 Assets donated by third parties (see also paragraph 6.2.24), either by gift of the asset or by way of funds to acquire assets (including national lottery-funded assets), and which meet the criterion in paragraph 6.2.20, should be capitalised at fair value on receipt. Where the value of the services provided by an asset will be less than the fair value of the asset because it is over-specified for its intended use, the lower value should be used. The amount capitalised should be credited to a donated asset reserve.
- 6.2.20 To qualify for treatment as a donated asset there should be no consideration given in return.
- 6.2.21 Donated assets do not include:
- (a) assets financed by grant-in-aid;
 - (b) the subsequent capitalised expenditure on a donated asset which is capitalised;
 - (c) assets constructed or contributed to by a developer to benefit the developer's business;
 - (d) assets accepted in lieu of tax.

These types of asset should be accounted for in accordance with IAS 16 in the same way as other assets of that general type.

- 6.2.22 Donated assets should be revalued, depreciated and subject to impairment review in the same way as other fixed assets. Revaluations should be taken to the donated asset reserve. Each year, an amount equal to the depreciation charge on the asset

and any impairment should be released from the donated asset reserve to the operating cost statement. No cost of capital charge will be imposed.

- 6.2.23 Details of any restrictions imposed by the donor on the use of the donated asset should be disclosed in a note to the financial statements.

Asset transfers

- 6.2.24 Entities (other than trading funds) may give or receive assets to/from another part of the public sector (including parts of the public sector not covered by the requirements of this Manual) for no consideration. Assets acquired in this way are not donated assets. Entities should consult the relevant authority (through sponsoring bodies where appropriate) before entering into such a transaction. Road detrunkings are an exception to this, and should be treated in the same way as Machinery of Government changes.

Heritage assets

- 6.2.25 Heritage assets are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. They are held by the reporting entity in pursuit of its overall objectives in relation to the maintenance of the heritage. Non-operational assets are those that are held primarily for this purpose. Operational heritage assets are those that, in addition to being held for their characteristics as part of the nation's heritage, are also used by the reporting entity for other activities or to provide other services (the most common example being buildings).
- 6.2.26 The reporting entity holding the asset should attest annually to the ongoing heritage credentials of its heritage assets. Heritage assets include historical buildings, archaeological sites, military and scientific equipment of historical importance, museum and gallery collections and works of art.

Interpretation of IAS 16 in respect of accounting for heritage assets

- 6.2.27 In principle, heritage assets should be accounted for in the same way as any other asset under IAS 16. There are, however, certain characteristics associated with heritage assets that give rise to the need for interpretation of IAS 16.

Definition

- a) Their value to government and the public in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value derived from a market mechanism or price.
- b) Established custom and, in many cases, primary statute and trustee obligations 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.
- d) They may require significant maintenance expenditure so that they can continue to be enjoyed by future generations.
- e) Their life might be measure in hundreds of years.

- f) Antiques and other works of arts held by reporting entities outside the main collections should be classified as heritage assets only when they fulfil the above requirements. Otherwise, antiques and other works of art should be accounted for in the same way as other assets.

Recognition and measurement

- g) Operational heritage assets should be valued in the same way as other assets of that general type (buildings, for example).
- h) Non-operational heritage assets should be valued (subject to the considerations set out in paragraph 6.2.28) on the following basis:
- I. Non-operational heritage assets purchased within the accounting period should be valued at cost;
 - II. Existing and newly donated non-operational heritage assets (and newly purchased assets on revaluation) should, where there is a market in assets of that type, be valued at market value for existing use or otherwise at depreciated replacement cost; or
 - III. Where there is no market in assets of that type, at depreciated replacement cost unless the asset would not or could not be replaced, when the value will be nil. (See paragraph 6.2.8 c) and the additional guidance referred to in paragraph 6.2.8 b)).

Disclosure

- i) Information on heritage assets (whether or not they have been capitalised) should be given in the notes to the financial statements and should contain:
- I. Sufficient information to enable the user to appreciate the age and scale of these assets, how they were acquired and what use is made of them;
 - II. Details of the cost (or value) of additions and disposals of heritage assets during the year or, where details of cost or valuation are not available, a brief description of the nature of the assets acquired or disposed of; and
 - III. In the accounting policies note, a note explaining the entity's capitalisation policy in relation to heritage assets and the measurement bases adopted for their inclusion in the accounts.

6.2.28 There may be instances where valuation of non-operational heritage assets may not be practicable or appropriate – either because reliable valuations (including original cost) cannot be obtained or because the costs associated with obtaining reliable valuations are onerous when compared with the additional benefits obtained by users of the financial statements (the cost/benefit analysis). For example, it might be possible to capitalise (at cost) non-operational heritage assets where the accounting records exist for past accounting periods, but not where the records no longer exist, since the cost of reconstructing them would be prohibitive, nor where the cost information is of such an age as to make it meaningless in terms of a reasonable view of the value of the asset today.

6.2.29 Examples of where it might be difficult to obtain a valuation include:

- a) museum and gallery collections and other collections existing at 31 March 2001 (but where the information is available in relation to additions made in earlier years, those additions should be capitalised subject to the considerations set out in paragraph 6.2.24), including the national archives; and
- b) archaeological sites, burial mounds, ruins, monuments and statues.

IAS 17 Leases, SIC 15 Operating Leases – Incentives, SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease, IFRIC 4 Determining whether an Arrangement contains a Lease, and IFRIC 12 Service Concession Arrangements

Applicability

6.2.30 IAS 17 and its interpretations apply in full to the reporting entities covered by this Manual.

Objectives of IAS 17

6.2.31 The main objective of IAS 17 is to ensure that entities account for the substance of any leasing agreement or hire purchase contract. IAS 17 requires all leases to be classified as either a finance lease or an operating lease depending on the substance. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. An operating lease is a lease other than a finance lease.

SIC 15 consensus

6.2.32 The consensus in SIC 15 is that all incentives for the agreement of a new or renewed operating lease shall be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the nature of the incentive or the timing of payments.

SIC 27 consensus

6.2.33 The consensus in SIC 27 is that a series of transactions that involve the legal form of a lease is linked. The series of transactions should be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole, reflecting the substance of the transaction.

IFRIC 4 consensus

6.2.34 The consensus in IFRIC 4 is that the determination of whether an arrangement is, or contains, a lease should be based on the substance of the arrangement and requires an assessment of whether fulfilment of the arrangement is dependent on the use of a specific asset or assets and whether the arrangement conveys the right to use the asset.

Accounting for PPP arrangements, including PFI contracts, under IFRS

Scope

6.2.35 This section of the Manual deals with the accounting treatment of PPP arrangements, including PFI contracts, that meet the definition of service concession arrangements in IFRIC 12 Service Concession Arrangements. To be within the scope of IFRIC 12, the service concession arrangement must contractually oblige the private sector operator to provide the services related to the infrastructure to the public on behalf of the grantor (the public sector) (IFRIC 12.3). Contracts that do not involve the transfer or creation of an infrastructure asset for the purpose of the contract fall outside the scope of IFRIC 12, as do arrangements that do not involve the delivery of services to the public. Examples of infrastructure for public services - are: roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, telecommunication networks, permanent installations for military etc. operations, and non-current assets used for administrative purposes in delivering services to the public.

6.2.36 The private sector operator will apply IFRIC 12 to those arrangements where:

- a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
- b) the grantor controls – through beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement.

Where the infrastructure asset is used for its entire useful life, and there is little or no residual interest, the arrangement would fall within the scope of IFRIC 12 where the grantor controls or regulates the services as described in the first condition (see also IFRIC 12.6). Significant residual interest will exist where the grantor is contractually required to purchase the infrastructure asset at the end of the term of the arrangement.

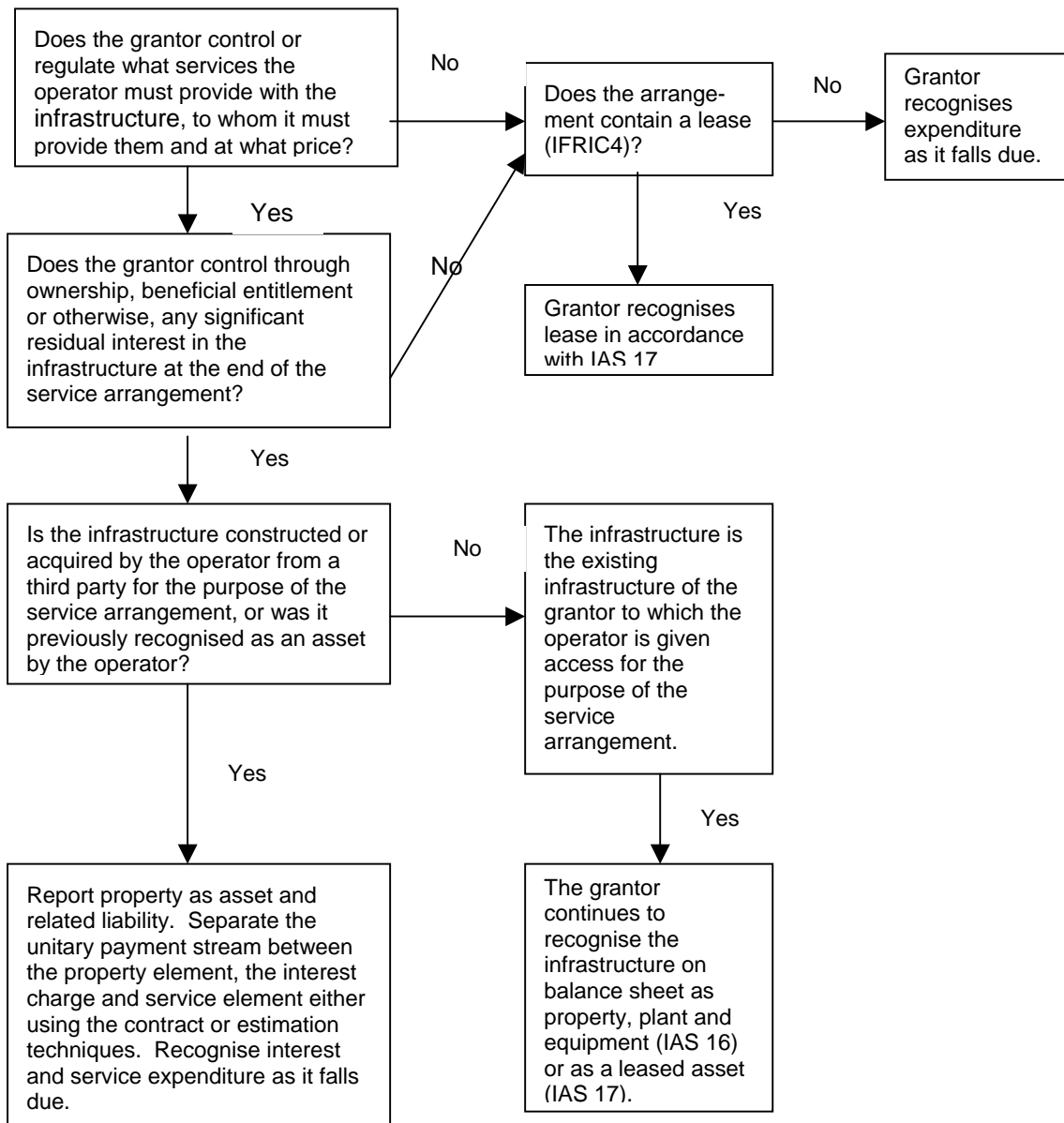
6.2.37 IFRIC 12 (Application Guidance paragraph 3) notes that, in determining the applicability of the first condition, non-substantive features (such as price capping that would apply only in remote circumstances) should be ignored and the substance of the arrangement considered.

6.2.38 IFRIC 12, including the Appendices, Information Notes, Illustrative Examples and Basis for Conclusions, provides guidance on how to apply IFRS to service concession arrangements. IFRIC 12 does not create exceptions from other IFRS for transactions that are within service concession arrangements, other than as specifically stated in IFRIC 12. Issues not addressed explicitly in this section of the Manual should be resolved by reference to other IFRS. IFRIC 12 applies to:

- arrangements where the infrastructure is used for its entire useful life;
- infrastructure that the operator constructs or acquires from a third party; and
- infrastructure that the grantor provides to the operator for the purpose of the concession.

IFRIC 12 does not specify the accounting for infrastructure that was held and recognised as an asset by the operator prior to entering the arrangement

(IFRIC 12.6-8). This is because the operator would de-recognise the asset under IAS 16. Paragraph 6.2.35 interprets IFRIC 12 for the public sector by including an asset previously owned by the operator within the criteria for recognising the arrangement as a service concession. The flowchart overleaf will assist in determining the appropriate accounting treatment of PPP arrangements, including PFI contracts by public sector grantors.



Initial recognition and measurement of assets and liabilities in new arrangements and contracts

6.2.39 Where there is infrastructure, whether previously owned by the contractor or the grantor, or constructed or acquired from a third party for the purpose of the service arrangement, and the grantor controls:

- a) or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
- b) through beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (or there is no residual interest),

then the PPP arrangement or PFI contract is a service concession within the meaning of IFRIC 12 from the grantor's viewpoint.

6.2.40 The grantor should recognise the infrastructure as a non-current asset and value it in the same way as other non-current assets of that generic type. The asset will be recognised when:

- a) it is probable that future economic benefits associated with the asset will flow to the organisation; and
- b) the cost of the asset can be measured reliably.

In practice, this means that the grantor will usually only recognise the asset when the asset comes into use. Where the grantor makes contributions to the operator in advance of the asset coming into use, the grantor should account for those payments as prepayments.

6.2.41 The asset will be measured in one of two ways:

- a) where the contract is separable between the service element, the interest charge and the infrastructure asset (see also paragraph 6.2.42), the asset will be initially measured following the guidance in IAS 17, with the service element and the interest charge recognised as incurred over the term of the concession arrangement (the subsequent measurement should be subject to the guidance of IAS 16; or
- b) where there is a unitary payment stream that includes infrastructure and service elements that cannot be separated, the various elements will be separated using estimation techniques as set out in paragraph 6.2.43.

6.2.42 The grantor should separate out the service, interest and infrastructure elements. A contract may be separable in a variety of circumstances, including but not limited to the following.

- a) the contract identifies an element of a payment stream that varies according to the availability of the property itself and another element that varies according to usage or performance of certain services;
- b) different parts of the contract run for different periods or can be terminated separately. For example, an individual service element can be terminated without affecting the continuation of the rest of the contract; or
- c) different parts of the contract can be renegotiated separately. For example, a service element is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

6.2.43 In situations where it is not possible to separate the contract due to commercial reality, the service element of the payments must be estimated, which could be achieved by obtaining information from the operator or by using the fair value approach. The fair value of the asset determines the amount to be recorded as an asset with an offsetting liability. The total unitary payment is then divided into three: the service charge element, repayment of the capital element of the contract obligation and the interest expense on it (using the interest rate implicit in the contract).

- 6.2.44 For both existing and new contracts, where it is not practicable to determine the interest rate implicit in the contract, the grantor shall use its cost of capital rate (including inflation). It is expected that this situation would be rare. The rate should not be changed unless the infrastructure element or the whole of the contract is renegotiated.
- 6.2.45 Entities covered by the requirements of this manual should use the cost of capital rate given in chapter 11 (paragraph 11.5.4). This rate is stated in real term and must be adjusted by adding the inflation rate to arrive at the nominal rate. The nominal rate can be calculated using inflation rates given in the table 16 of the Treasury's Pocket Data Bank. The Pocket Data Bank can be found at: http://www.hm-treasury.gov.uk/data_indic_index.htm.
- 6.2.46 Under either approach, the grantor will recognise a liability for the capital value of the contract. That liability does not include the interest charge and service elements, which are expensed annually to the Operating Cost Statement.

Initial recognition of existing arrangements which were off-balance sheet under UK GAAP

- 6.2.47 On initial recognition of existing PPP arrangements or PFI contracts under this approach (that is, those arrangements or contracts that had previously been off-balance sheet), reporting entities should measure the non-current asset at the opening balance sheet date in the same way as other non-current assets of that generic type. The liability should be measured at its fair value at the balance sheet date, which will normally be the outstanding liability in respect of the property (that is, excluding the interest and service elements), discounted by the interest rate implicit in the contract.

Subsequent measurement

- 6.2.48 Reporting entities should adopt an appropriate asset revaluation approach as set out earlier in this chapter. Liabilities will be measured using the appropriate discount rate, taking account of the reduction arising from the capital payments included in the unitary payment stream.

Income generated by the grantor from the service concession arrangements

- 6.2.49 Revenue received under any revenue sharing provision in the service concession arrangement should be recognised when all the conditions as laid down in IAS 18 have been satisfied.

Consideration given by the grantor to the operator (guarantees made by the grantor as part of the arrangement)

- 6.2.50 The grantor should recognise any guarantees to the operator that it will meet any shortfalls in revenue or repay the debt if the operator defaults in line with the requirements of IAS 32 and IAS 39. Additional guidance on accounting for financial instruments is available on the Manual's dedicated website.

Items provided to the operator by the grantor

6.2.51 The grantor should derecognise a non-current asset provided to the operator (and not used in the arrangement) and recognise any consideration received at fair value. If the consideration received is in the form of a reduction in future payments, this should be recognised as an asset representing a reduction in the future liability (normally as a prepayment).

Disclosure

6.2.52 The disclosure requirements in respect of PPP arrangements, including PFI contracts, are set out in chapter 5 of this manual.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance and SIC 10 Government Assistance – No Specific Relation to Operating Activities***Applicability***

6.2.53 IAS 20 and SIC 10 apply, as interpreted, to all reporting entities covered by this Manual.

Objective of IAS 20

6.2.54 The objective of IAS 20 is to prescribe the accounting treatment for government grants and the disclosures about other government assistance.

SIC 10 consensus

6.2.55 The consensus in SIC 10 is that government assistance to entities meets the definition of government grants even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. Such grants should not be credited directly to equity.

Interpretation of IAS 20 and SIC 10 for the public sector context

6.2.56 In applying IAS 20 and SIC 10, entities should be aware of the following interpretations for the public sector context.

Recognition

- a) Parliamentary Supply (the parliamentary grant in Wales) does not fall within the meaning of government grants;
- b) Entities receiving a grant (not grant-in-aid) to fund the purchase of a specific asset should credit that grant to a government grant reserve which should be released to income over the useful life of the asset. The option provided in IAS 20 to offset the grant against the cost of the asset is not available.

Other requirements

6.2.57 The following requirements should be observed by entities covered by this Manual.

- a) The notes to the financial statements should distinguish between grants from UK government entities and grants from the European Union.
- b) As it is important for monitoring and control purposes, entities that receive grant in aid that is intended to finance both revenue and capital expenditure should analyse the grant in aid between its constituent parts, notwithstanding that it will be credited in total to the income and expenditure reserve.

Summary of accounting treatment

6.2.58 Grants and grants-in-aid shall be accounted for as follows:

- a) grants-in-aid, whether for revenue or capital purposes, are to be treated as contributions from controlling parties giving rise to a financial interest in the residual interest of the reporting entity, and are to be credited to general reserves and not, respectively, to income or deferred income. In the case of grants-in-aid for general capital purposes, it will not be necessary to release amounts to the income and expenditure account to offset reserves;
- b) grants for revenue purposes will normally be accounted for in the same way as grants-in-aid, unless it can be demonstrated that they are provided in return for specific goods or services, in which case they are to be credited to income. Any proposal to account for grants as income should be approved by the sponsoring department and the relevant authority;
- c) grants provided to finance the purchase of a specific fixed asset are to be credited to a government grant reserve which is released to income over the useful economic life of the asset;
- d) on disposal of an asset financed by a grant, the profit or loss is taken to the income and expenditure account/operating costs statement and is offset by a transfer from the government grant reserve of the same proportion of the profit or loss that the amount of the grant bears to the original cost of the asset. The balance on the government grant reserve in respect of that asset should be transferred to the income and expenditure reserve/general fund representing that same proportion of the proceeds;
- e) the profit or loss on disposal of an asset financed by grant-in-aid is taken to the income and expenditure account/operating cost statement; and
- k) grant-in-aid is provided to match the recipient's cash needs and is to be accounted for on a cash basis. Any exceptions to this treatment must be agreed by the sponsoring department and the relevant authority.

IAS 23 Borrowing Costs

Applicability

6.2.59 IAS 23 applies as interpreted to all reporting entities covered by this Manual. However, IAS 23 does not apply where a qualifying asset is carried at fair value (IAS 23.4).

Objective of IAS 23

6.2.60 The objective of IAS 23 is to prescribe the accounting treatment of borrowing costs. The Standard requires the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. All other borrowing costs should be recognised as an expense.

Interpretation of IAS 23 for the public sector context

6.2.61 In applying IAS 23, reporting entities should be aware of the following interpretation for the public sector context.

Recognition

- a) Borrowing costs in respect of qualifying assets held at fair value shall be expensed;
- b) The cost of capital charge is not a borrowing cost and does not fall within the scope of IAS 23.

IAS 40 Investment Properties

Applicability

6.2.62 IAS 40 applies in full to all reporting entities covered by this Manual that hold (or are constructing or developing) properties only for the purpose of earning rentals or for capital appreciation or both. If earning rentals were an outcome of a regeneration policy, for example, the properties concerned would be accounted for under IAS 16 and not IAS 40.

Objectives of IAS 40

6.2.63 The objective of IAS 40 is to prescribe the accounting treatment for investment property and related disclosure requirements.

Interpretation of IAS 40 for the public sector context

6.2.64 In applying IAS 40, reporting entities should be aware of the following interpretation for the public sector context.

Measurement after recognition

- a) All investment property should be accounted for under the fair value model – that is, the option given in IAS 40 to adopt the cost model has been withdrawn.

IAS 41 Agriculture

Applicability

6.2.65 IAS 41 applies in full to agricultural activities undertaken for commercial gain by any reporting entity covered by this Manual.

Objectives of IAS 41

6.2.66 The objective of IAS 41 is to prescribe the accounting treatment, financial statement presentation and disclosures related to agricultural activity. Agricultural activity is the management by an entity of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Applicability

6.2.67 IFRS 5 applies in full, as interpreted, to all entities covered by the requirements of this Manual.

Objectives of IFRS 5

6.2.68 The objectives of IFRS 5 are to specify that:

- a) assets held for sale should be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on those assets should cease; and
- b) assets held for sale should be presented separately, either on the face of the statement of financial position or in the notes, and the results of discontinued operations should be presented separately in the income statement.

Interpretation of IFRS 5 for the public sector context

6.2.69 The following interpretations of IFRS 5 defined terms apply:

- a) in order to qualify as 'discontinued operations', the activities must cease completely: that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes) are not discontinued operations; and
- b) the 'value in use' of a non-cash-generating asset is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.