

- (b) if it applies the cost model, the depreciation or amortisation of investment property and accumulated impairment losses;
- (c) if it applies the fair value model, the basis and methods applied in determining the fair value of investment property and the amount of change in fair value recognised in profit or loss;
- (d) circumstances and reasons for the transfer of the investment property and its effect on profit or loss and owners' equity; and
- (e) the disposal of investment property for the period and its effect on profit or loss.

Chapter 6

ASBE 4 FIXED ASSETS

Introduction	¶6-100
Nature	¶6-200
Recognition	¶6-300
Measurement at recognition and determination of cost	¶6-400
Initial cost	¶6-410
Subsequent expenditure	¶6-420
Depreciation	¶6-500
Scope of depreciation accounting	¶6-510
Determination of depreciation charge	¶6-520
Recording the depreciation charge	¶6-530
Misconception	¶6-540
Impairment	¶6-600
Disposal	¶6-700
Non-current assets held for sale	¶6-800
Disclosure	¶6-900

¶6-100 Introduction

ASBE 4 *Fixed Assets* supersedes the Standard, *Fixed Assets (2002)* and prescribes the recognition and measurement of fixed assets and the disclosure of related information in financial statements according to the requirements of the *Basic Standard*. It becomes operative for listed enterprises from 1 January 2007. Other enterprises are encouraged to apply its provisions.

ASBE 4, however, is not applicable to the following (para 2):

- (a) buildings held as investment properties (which are covered under ASBE 3 *Investment Property*); and
- (b) bearer biological assets (which are covered under ASBE 5 *Biological Assets*).

An enterprise should, taking into account its specific circumstances, for those fixed assets that meet the definition and recognition criteria of ASBE 4, set up a fixed assets register and determine a classification of fixed assets, the useful life, net residual value and depreciation method for each item or class of fixed assets.

Interpretation No. 1 (*Caikuai* [2007] No. 14), issued by the Ministry of Finance on 16 November 2007, and the *Explanatory Guidance — Chapter 5 Fixed Assets*, provide guidance for fixed assets and other non-current assets such as intangible assets to be classified as held for sale and their proper accounting treatment.

¶6-200 Nature

Fixed assets are defined in ASBE 4 as tangible assets that are (para 3):

- (a) held for use in the production or supply of goods and services, for rental to others, or for administrative purposes; and
- (b) have a useful life of more than one year.

Thus, to qualify as a fixed asset under ASBE 4, an asset must possess the following two characteristics:

- (a) it is being used in operations — only assets used in the normal operations of the business should be classified as fixed assets (for example, motor vehicles held by car dealers for resale should be accounted for as inventory under ASBE 1 *Inventories*); and
- (b) it possesses physical substance — fixed assets are characterised by tangible physical substance and are thus differentiated from intangible assets such as patents and brands (intangible assets is covered under ASBE 6 *Intangible Assets*).

Furthermore, ASBE 4 emphasises that a fixed asset has a useful life of over one year (they are expected to yield services over several accounting periods).

Examples of fixed assets include buildings and structures, machinery and equipment, vehicles and other equipment, apparatus and tools relating to the production and operations of an enterprise.

¶6-300 Recognition

ASBE 4 provides that an item of fixed asset should be recognised if, and only if (para 4):

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

The first criterion is satisfied when there is a high degree of certainty attached to the flow of economic benefits at the time of the initial recognition. Generally, it is satisfied when the risks and rewards incidental to the ownership of the asset have been transferred to the enterprise.

The second criterion is easily satisfied for a fixed asset acquired from the market because of the existence of an external transaction evidencing the identification of the cost. For an internally constructed fixed asset, a reliable measurement of the costs incurred in the construction is also often readily available.

The existence of a physical form usually makes the recognition of a fixed asset based on the two criteria less problematic than that of an intangible asset.

Paragraph 5 of ASBE 4 provides that parts (or components) of fixed assets should be recognised as individual items of assets provided that they have different useful lives or provide benefits to the enterprise in different patterns, thus requiring the use of different depreciation methods (or rates). For example, the engines used in an aircraft often have a different useful life from the body parts (eg three-year life for the engines and eight-year life for the body parts). If this is the case, the enterprise should depreciate the engines and the body parts over their respective useful lives.

In identifying the separate (components) parts of fixed assets, judgment is required in applying the definition and recognition criteria of ASBE 4 to the specific circumstances of enterprises. It may be appropriate to aggregate individually insignificant items (such as moulds, tools and dies) and to apply the definition and recognition criteria to the aggregate value.

Usually spare parts and servicing equipment are carried as inventory and recognised as an expense when consumed. However, major spare parts and stand-by equipment qualify for recognition as fixed assets when the enterprise expects to use them for more than one year. Similarly, if the spare parts and servicing equipment can be used only in connection with the fixed assets, they are accounted for as fixed assets.

MEASUREMENT AT RECOGNITION AND DETERMINATION OF COST

¶6-400 Measurement at recognition and determination of cost

ASBE 4 provides that a fixed asset should initially be measured at its cost (para 7).

The cost of a fixed asset normally comprises two components:

- (1) the initial cost of acquisition; and
- (2) subsequent expenditure incurred.

¶6-410 Initial cost

Fixed assets may be acquired through a purchase transaction or an exchange transaction, or it may be constructed internally, or acquired or obtained in other circumstances (eg investor-contributed, by lease, through debt restructuring, etc). ASBE 4 provides specific guidance on the determination of the initial cost of these fixed assets in each circumstance.

Purchased fixed asset

Paragraph 8 of ASBE 4 provides that the initial cost of a purchased fixed asset separately comprises:

- its purchase price, including related taxes; and
- any attributable expenditures incurred in bringing the asset to its working condition for intended use.

In most cases, the "purchase price" is easily determined, given that there is a purchase transaction. However, where the purchase price is not quoted or payable in cash, there may be some difficulty in determining the amount to be treated as the cost of the fixed asset. In such cases, the "cash price equivalent" of the purchase price is used at the recognition date.

Cash discounts are rarely used in China's commercial practice. However, in situations where the terms of purchase allow for a cash discount, a common practice is to deduct the cash discount (whether or not taken) from the purchase price, so that only the "cash price equivalent" is recognised as part of the cost of the fixed asset.

Illustration 6.1

Assume that a piece of equipment is purchased at a quoted price of RMB1,000,000 on a term of 2/20, n/60 (meaning a discount of 2% will be given if the payment is made within 20 days, or else the full price of RMB1,000,000 will have to be paid within 60 days).

In this case, the purchase price should be recorded at its "cash price equivalent" of RMB980,000 (RMB1,000,000 less cash discount of RMB20,000) irrespective of whether the cash discount is taken advantage of.

If the price is paid within 20 days, the journal entry will be as follows:

	RMB	RMB
Dr Fixed assets—Equipment	980,000	
Cr Cash in bank		980,000

If the price is paid after the 20th day, the journal entry will be as follows:

	RMB	RMB
Dr Fixed assets—Equipment	980,000	
Dr Financial expenses	20,000	
Cr Cash in bank		1,000,000

Where fixed assets are purchased and to be paid for beyond normal credit terms and the arrangement is effectively of a financing nature, the concept of "cash price equivalent" should again be used. The cash price equivalent will

be equal to the present value of the cash payments. The difference between the cash price equivalent and the total payment is recognised as interest expense in profit or loss over the period of credit unless such interest is capitalised in accordance with ASBE 17 *Borrowing Costs* (para 8).

Illustration 6.2

Assume that a piece of specialised equipment is purchased under an agreement which provides for payment of five equal yearly instalments of RMB1,000,000 each at the end of each year after the date of purchase.

In this case, to record the purchase price of the equipment at RMB5,000,000 is to ignore the fact that there are interest charges in the contract.

Assuming an interest rate of 10%, the equipment should be recorded at RMB3,790,800, i.e. the present value of the cash payments ($\text{RMB1,000,000} \times 3.7908 = \text{RMB3,790,800}$). The journal entry to record the transaction will be as follows:

	RMB	RMB
Dr Fixed assets—Equipment	3,790,800	
Dr Deferred expenses—Financial expenses	1,209,200	
Cr Notes payable		5,000,000

Note:

The deferred interest is to be recognised as interest expense over five years.

As mentioned above, the initial cost of purchased fixed assets not only includes the purchase price, but also "any attributable expenditures of bringing the asset to the working condition for its intended use".

Some examples of attributable expenditures are:

- cost of site preparation;
- initial delivery and handling costs;
- installation and assembly costs;
- cost of testing whether the fixed asset is functioning properly; and
- professional fees such as lawyers', architects' and engineers' fees.

IAS 16 *Property, Plant and Equipment* provides further guidance on "attributable expenditures". It specifically mentions that the following are not the costs of fixed assets:

- costs of opening a new facility;
- costs of introducing a new product or service;
- costs of conducting business in a new location or with a new class of customers; and

(d) administration and other general overhead costs.

The above items do not form part of the cost of fixed assets since they are neither involved in the acquiring of the asset nor the bringing of the asset to its working condition.

Illustration 6.3

AB Enterprise acquires a piece of land for the purpose of building a factory on it. Assume that the following expenditures are incurred (ignore related taxes):

- purchase price of land: RMB1,000,000;
- legal fees for land purchase: RMB50,000;
- cost of demolishing an old building on the land: RMB30,000;
- cost of clearing and levelling the land: RMB80,000;
- architect's fee for the factory: RMB20,000;
- cost of construction of the factory: RMB1,500,000; and
- cost of constructing and demolishing living quarters for the workers building the factory: RMB60,000.

Since the land is acquired for the purposes of constructing a factory on it, the cost of demolishing the old building and the cost of clearing and levelling, which are necessary to bring the land to the working condition for its intended use, ie for the construction of the factory, should be properly recognised as part of the cost of land. The architect's fee and the cost of constructing and demolishing the workers' quarters are necessary for the construction of the factory, and should therefore be included in the cost of building the factory.

Thus, items (a) to (d) should be recognised as part of the cost of land (totalling RMB1,160,000), and items (e) to (g) should be recognised as part of the cost of building (totalling RMB1,580,000).

The following criteria are used in the judgment process regarding whether the acquired fixed asset has reached the state of "working condition for its intended use" (or "expected usable condition"):

- the physical construction (including installation) of the asset is complete or substantially complete;
- the acquired or constructed asset meets or basically meets the design or contract requirements; and
- expenditure incurred thereafter for the acquisition or construction of the asset is remote, possibly zero or almost does not incur again.

If the fixed asset being acquired requires trial-production or trial-operation, the asset should be considered as having reached the expected usable condition (or working condition for its intended use) if the trial-production process demonstrates that the asset can produce qualified products in a normal way or the trial-operating process demonstrates that the asset can operate normally.

When a lump sum payment is made for purchasing several fixed assets that are not priced separately, ASBE 4 requires the cost of each asset to be determined by allocating the total payment according to the proportion of fair value of each asset to the total fair value of all assets acquired (para 8).

Illustration 6.4

On 1 January 2009 CD Enterprise purchases three different types of equipment (X, Y and Z) together from a supplier for a total amount of RMB8,000,000 and pays a value-added tax (VAT) of RMB1,400,000 and installation costs of RMB60,000. Assume the input VAT shall form part of costs of the fixed assets in accordance with tax laws.

Assume that the fair value of equipment X, Y and Z is RMB2,460,000, RMB3,690,000 and RMB2,050,000 respectively.

In this case, the total amount of payment (RMB9,460,000) should be allocated to the cost of each fixed asset as follows:

Equipment X	=	RMB9,460,000 × [2,460,000 / (2,460,000 + 3,690,000 + 2,050,000)]
	=	RMB9,460,000 × 30%
	=	RMB2,838,000
Equipment Y	=	RMB9,460,000 × [3,690,000 / (2,460,000 + 3,690,000 + 2,050,000)]
	=	RMB9,460,000 × 45%
	=	RMB4,257,000
Equipment Z	=	RMB9,460,000 × [2,050,000 / (2,460,000 + 3,690,000 + 2,050,000)]
	=	RMB9,460,000 × 25%
	=	RMB2,365,000

When determining the cost of a fixed asset, ASBE 4 requires that an enterprise also consider the estimated decommissioning costs (para 13). The decommissioning costs of a fixed asset generally refer to the expenditures identified for environmental protection and restoration of the natural environment. Such expenditures are undertaken by an enterprise according to the laws and administrative regulations. The *Application Guidance* and the *Explanatory Guidance* — Chapter 5 *Fixed Assets* provide that obligations for the demolition, removal and restoration of a fixed asset undertaken by an enterprise should be recognised as estimated liabilities and recognised as part of the cost of the asset if the obligations meet the recognition criteria for estimated liabilities as set out in ASBE 13 *Contingencies*. If the recognition criteria for estimated liabilities are not met, such expenditures should be recognised as disposal expenses when incurred. Obligations for the costs of disposition of surrendered mineral properties undertaken by an enterprise

should, however, be accounted for in accordance with ASBE 27 *Extraction of Petroleum and Natural Gas and its Application Guidance*.

Illustration 6.5

On 1 January 2008, EF Enterprise purchases a plant for a cash consideration of RMB30,000,000. However, EF Enterprise is required to dismantle the plant after a 20-year period. It is estimated that the dismantlement will cost RMB10,000,000. The relevant discount rate (ie effective interest rate) is 6%, and the present value of the dismantlement cost is therefore RMB3,120,000 ($\text{RMB10,000,000}/(1 + 6\%)^{20}$).

In this case, EF Enterprise will record the plant at a cost of RMB33,120,000 on 1 January 2008 as follows:

	RMB	RMB
Dr Fixed assets — Plant	33,120,000	
Cr Cash in bank		30,000,000
Cr Estimated liabilities — Decommissioning cost		3,120,000

On 31 December 2008, EF Enterprise has to provide depreciation on the plant, by allocating the cost of RMB33,120,000 over 20 years. Besides that, EF Enterprise will also have to account for the change in the decommissioning cost due to the accrual of interest charge. In this case, the present value of the decommissioning cost has increased from RMB3,120,000 to RMB3,307,200 ($\text{RMB3,120,000} \times 1.06$) because of the accrual of interest charge. The journal entry to record this change is as follows:

	RMB	RMB
Dr Financial expenses ($\text{RMB3,120,000} \times 6\%$)	187,200	
Cr Estimated liabilities — Decommissioning cost		187,200

On 31 December 2009, the journal entry to record the financial expenses is as follows:

	RMB	RMB
Dr Financial expenses ($\text{RMB3,307,200} \times 6\%$)	198,432	
Cr Estimated liabilities — Decommissioning cost		198,432

It may be noted that IFRIC-Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* further provides that changes in decommissioning cost arising from changes in estimate and discount rates should be adjusted to the cost of the asset in the current period prospectively, and changes in

decommissioning cost due to accrual of interest charge should be accounted for as a finance expense as it occurs.

In Illustration 6.5 above, assume that on 31 December 2016, it is estimated that, due to technological advancement, the dismantlement cost will be just RMB8,000,000. In this case, the present value of the decommissioning cost will change from RMB5,200,000 (RMB10,000,000 discounted at 6% for 11 periods) to RMB4,210,000 (RMB8,000,000 discounted at 6% for 11 periods). The journal entry to record this change is as follows:

	RMB	RMB
Dr Estimated liabilities — Decommissioning cost	990,000	
Cr Fixed assets — Plant		990,000

The annual depreciation charge for the years 2008 to 2016 will be based on the cost of RMB33,120,000, whereas the depreciation for years thereafter will be based on the cost of RMB32,130,000 ($\text{RMB33,120,000} - \text{RMB990,000}$).

Self-constructed fixed assets

For self-constructed (or self-manufactured) fixed assets, it is logical to apply the same principles as for purchased fixed assets.

Specifically, paragraph 9 of ASBE 4 states that the cost of a self-constructed fixed asset would consist of the total amount of expenditure necessarily incurred to bring the asset to working condition for its intended use (or to its expected usable condition). The expenditure generally includes the cost of direct material (including transportation and insurance costs), cost of direct labour, cost of direct mechanical expenses and subcontractor costs.

Cost incurred during the trial-operation before making the fixed assets for its intended use should be accounted for as part of the cost of construction in progress. Where products produced during the trial-operation can be sold to third parties, the cost incurred on the products should be accounted for as part of the cost of construction in progress, and be recorded to offset the cost of construction based on the actual or estimated sales proceeds when the products are sold or converted into goods on hand.

When a fixed asset under construction reaches its "expected usable condition" but the final total cost of construction has yet to be determined, it should be transferred to fixed assets and measured at the estimated value based on the budgeted price or actual cost of the work from the date on which it reaches its expected usable condition. The recorded amount of the fixed asset should be adjusted after the final total cost of construction is determined.

Where there is normal damage or wastage to a single or unit construction, the net losses after deductions of the residual value and compensation from