



ACCOUNTING STANDARDS BOARD

DIRECTIVE 7: THE APPLICATION OF DEEMED COST ON THE ADOPTION OF STANDARDS OF GRAP



Accounting Standards Board

Directive 7

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Accounting Standards Board

P O Box 74129

Lynnwood Ridge

0040

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DIRECTIVE 7: THE APPLICATION OF DEEMED COST ON THE ADOPTION OF STANDARDS OF GRAP

Introduction

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of Statements of Generally Accepted Accounting Practice (GAAP), codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) to be GRAP for:

- (a) government business enterprises (GBEs)(as defined in the PFMA);
- (b) trading entities (as defined in the PFMA);
- (c) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly traded on the capital markets; and
- (d) entities under the ownership control of any of these entities.

The Board believes that Statements of GAAP are relevant and applicable to financial statements prepared by all such entities including those under their ownership control.

Section 89(1)(b) of the PFMA, requires the Board to prepare and publish directives and guidelines concerning the Standards of GRAP as set in paragraph 89(1)(a) of the PFMA. The *Preface to the Standards of GRAP* determines that directives will be used to set transitional provisions and transitional arrangements for the entities required to comply with Standards of GRAP. Directives issued by the Board in terms of section 89(1)(b) of the PFMA therefore have the same authority as the Standards of GRAP.

Directives should be read in conjunction with the relevant Standards of GRAP or Interpretations of Standards of GRAP, as well as the *Preface to the Directives*.

Objective

- .01 The purpose of this Directive is to outline when an entity applies a deemed cost if the acquisition cost of assets cannot be determined on the adoption of certain Standards of GRAP, and how that deemed cost should be determined.

Scope

- .02 This Directive shall be applied by entities that apply Standards of GRAP. This Directive can only be used to determine the cost of assets that were acquired prior to the measurement date outlined in paragraph .04, and only if information about the historical cost of those assets is not available.
- .03 This Directive does not address:
- (a) the deemed cost of inventories and similar current assets as it is not likely that the cost or fair value of these assets cannot be determined. The short-term nature of inventory and similar current assets requires that they are purchased frequently and written down when appropriate;
 - (b) the deemed cost of biological assets that form part of an agricultural activity. These assets are initially measured at fair value in accordance with the Standard of GRAP on *Agriculture*; and
 - (c) the cost of assets acquired through a non-exchange transaction, as part of a transfer of functions or through an entity combination.

Definitions

- .04 The following terms are used in this Directive with the meanings specified:
- Acquisition cost: When an entity initially recognises assets such as items of property, plant and equipment, investment properties, intangible assets and heritage assets using the Standards of GRAP, it measures those assets using either cost (if the asset is acquired in an exchange transaction) or at fair value (if the asset is acquired in a non-exchange transaction). This cost or fair value on initial acquisition of an asset is the acquisition cost.
 - Deemed cost: Deemed cost is a surrogate value for the cost or fair value of an asset at its initial acquisition, and is determined by reference to the fair value of the asset at the date of adopting the Standards of GRAP measurement date).
 - Measurement date (for purposes of this Directive): Measurement date is the date that an entity adopts the Standards of GRAP and is the beginning of the earliest period for which an entity presents full comparative information, in its first financial statements prepared using Standards of GRAP.

The application of deemed cost on the adoption of the Standards of GRAP

Use of deemed cost for property, plant and equipment, investment property, intangible assets and heritage assets

- .05 When an entity initially recognises an asset using the Standards of GRAP, it measures such assets using either cost or fair value at the date of acquisition (acquisition cost). Where the acquisition cost of an asset is not available on the adoption of the Standards of GRAP, acquisition cost is measured using a surrogate value (deemed cost) at the date an entity adopts the Standards of GRAP (measurement date). Deemed cost is determined as the fair value of an asset at the measurement date.
- .06 An entity may have determined a deemed cost for an asset under another basis of accounting where information about the acquisition cost of the asset was unavailable. A deemed cost determined for an asset under another basis of accounting is acceptable for purposes of this Directive if it represents the fair value of the asset as described in paragraph A2. or, its cost or depreciated historical cost.
- .07 In the absence of information about the acquisition cost of an asset, deemed cost is used for the following assets:
- (a) Property, plant and equipment.
 - (b) Investment property, only if an entity elects to use the cost model in the Standard of GRAP on *Investment Property*. If an entity adopts the fair value model for investment property, it measures investment property at fair value at the date the entity adopts the Standards of GRAP.
 - (c) Intangible assets that meet:
 - (i) the recognition criteria in the Standard of GRAP on *Intangible Assets*; and
 - (ii) the criteria in the Standard of GRAP on *Intangible Assets* for revaluation (including the existence of an active market).
 - (d) Heritage assets (see the Standard of GRAP on *Heritage Assets*).

An entity shall not use deemed cost for other assets or for liabilities.

- .08 With the exception of .07(b) above, an entity applies this Directive irrespective of whether it applies the cost or revaluation model in accordance with the Standards of GRAP on *Property, Plant and Equipment*, *Intangible Assets* or *Heritage Assets*.

- .09 If fair value at the measurement date cannot be determined for an item of property, plant and equipment, investment property or a heritage asset, an entity may estimate such fair value using:
- (a) depreciated replacement cost at the measurement date for an item of property, plant and equipment;
 - (b) depreciated replacement cost at the measurement date for an investment property, but only if the investment property is of such a specialised nature that there is no market-based evidence of fair value; and
 - (c) replacement cost at the measurement date for heritage assets.
- .10 If an entity uses deemed cost for an item of property, plant and equipment, an investment property, an intangible asset or a heritage asset, in its first statement of financial position prepared using Standards of GRAP, the entity's financial statements shall disclose:
- (a) for each line item:
 - (i) the aggregate of those items valued using deemed cost;
 - (ii) the aggregate adjustment to the carrying amounts previously reported; and
 - (b) a description of whether deemed cost was determined:
 - (i) using fair value or depreciated replacement cost for items of property, plant and equipment and investment properties; and
 - (ii) using fair value or replacement cost for heritage assets.

Use of deemed cost for investments in controlled entities, jointly controlled entities and associates

- .11 When an entity prepares separate financial statements, the Standard of GRAP on *Consolidated and Separate Financial Statements* requires it to account for its investments in controlled entities, jointly controlled entities and associates either:
- (a) at cost; or
 - (b) in accordance with the Standard of GRAP on *Financial Instruments*.
- .12 If an entity measures such an investment at cost in accordance with paragraph .11, it shall measure that investment at one of the following amounts in its first separate statement of financial position prepared using Standards of GRAP:
- (a) cost determined in accordance with the Standard of GRAP on *Consolidated and Separate Financial Statements*; or
 - (b) deemed cost if information about the cost of the investment is not available. The deemed cost of such an investment shall be its fair value (determined in accordance with the Standard of GRAP on *Financial Instruments*) at the measurement date.



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- .13 If an entity uses a deemed cost in its first statement of financial position prepared using Standards of GRAP for an investment in a controlled entity, jointly controlled entity or associate in its separate financial statements, the entity's first separate financial statements shall disclose:
- (a) the aggregate of those investments valued using deemed cost; and
 - (b) the aggregate adjustment to the carrying amounts previously reported.

Effective date

- .14 The effective date of this Directive is determined by reference to the effective date of the applicable Standards of GRAP, as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Appendix

This appendix is an integral part of the Directive.

Use of deemed cost for property, plant and equipment, investment property, intangible assets and heritage assets

- A1. An entity uses deemed cost for an item of property, plant and equipment, an investment property, an intangible asset or a heritage asset using fair value at the date of adopting the Standards of GRAP where information about the acquisition cost of an asset is not available. The deemed cost provisions outlined in this Directive are applied on an asset by asset basis.
- A2. Deemed cost, using fair value at the date of adopting the Standards of GRAP, is determined as follows:
- (a) The fair value of items of property, plant and equipment is determined using paragraphs .40 to .43 of the Standard of GRAP on *Property, Plant and Equipment* (Issued in 2004). For specialised items of property, plant and equipment, e.g. infrastructure assets, an entity may use depreciated replacement cost as deemed cost.
 - (b) The fair value of investment properties is determined using paragraphs .44 to .60 of the Standard of GRAP on *Investment Property* (Issued in 2004). If an investment property is of such a specialised nature that market based evidence of fair value is not available, an entity may use depreciated replacement cost as deemed cost.
 - (c) The fair value of intangible assets is determined using paragraphs .80 to .81 of the Standard of GRAP on *Intangible Assets* (Issued in 2007). As intangible assets can only be measured at fair value using a price in an active market, under the revaluation model in the Standard of GRAP on *Intangible Assets*, an entity cannot use depreciated replacement cost as deemed cost.
 - (d) The fair value of heritage assets is determined using paragraphs .35 to .45 of the Standard of GRAP on *Heritage Assets* (Issued in 2008). An entity may use replacement cost as deemed cost.
- A3. For the purposes of this Directive, the measurement of assets at fair value on the adoption of the Standards of GRAP, does not constitute:
- (a) a revaluation in accordance with the Standards of GRAP on *Property, Plant and Equipment, Intangible Assets or Heritage Assets*; or
 - (b) the application of the fair value model in the Standard of GRAP on *Investment Property*.
- A4. Subsequent depreciation, if applicable, is based on that deemed cost and starts from the measurement date.

Use of deemed cost for investments in controlled entities, jointly controlled entities and associates

- A5. An entity may elect to use cost in its separate financial statements for an investment in a controlled entity, jointly controlled entity or associate. Where information about the cost of the investment is not available, an entity uses a deemed cost. Deemed cost is the fair value of the investment at the date an entity adopts the Standards of GRAP, and is determined using the Standard of GRAP on *Financial Instruments*.

Initial entries using deemed cost

- A6. When an entity initially measures assets using the deemed cost approach in this Directive, it recognises the effect:
- (a) as an adjustment to the opening balance of accumulated surpluses or deficits in the opening statement of financial position prepared using Standards of GRAP; or
 - (b) in revaluation surplus if an entity adopts the revaluation model in the Standards of GRAP on *Property, Plant and Equipment, Intangible Assets* or *Heritage Assets*.

Effective date

- A7. The effective date of this Directive coincides with the effective dates of the relevant Standards of GRAP, as determined by the Minister of Finance.
- A8. If an entity has assets that it previously could not recognise and/or measure in accordance with the Standards of GRAP on their initial adoption because information about the acquisition cost of the assets was not available, an entity applies this Directive to those assets. The fair value of those assets is determined at the date of adopting the Standards of GRAP in accordance with paragraph A2. of this Directive.