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Capitalisation Policy

Ausgrid

Finance Policy

FINANCE MANAGEMENT	Document No	:	FM000-Y0065
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FM000-Y0065 CAPITALISATION (PROPERTY, PLANT AND EQUIPMENT)

1.0 POLICY STATEMENT

The entity will classify expenditure as capital when the definition and recognition criteria for an asset are in accordance with the Australian Accounting Standards.

The entity's assets primarily consist of system assets and non-system assets. All costs of system assets constructed by the entity are capitalised and all costs of non-system assets purchased above $500 are capitalised.

2.0 PURPOSE

The purpose of this policy is to provide the key requirements to account for the capitalisation of property, plant and equipment for the entity in order to comply with Australian Accounting Standards.

3.0 REFERENCES

Internal
Finance Policy (Finance Management) – Capitalisation of Borrowing Costs
Finance Policy (Finance Management) – Labour On-Cost Accounting
Network Standard NS145 Pole Inspection and Treatment Procedures

External
Australian Accounting Standard AASB 116 Property, Plant and Equipment
Australian Accounting Standard AASB 123 Borrowing Costs
Australian Accounting Standard AASB 137 Provisions, Contingent Liabilities and Contingent Assets

4.0 DEFINITIONS

Asset
An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

De-recognition
De-recognition means that the carrying amount of an item of property, plant and equipment shall be removed from the fixed assets register on disposal or when no future economic benefits are expected from its use or disposal.

Directly attributed to
"Directly attributed to" means those costs that would have been avoided if the expenditure on the asset had not been made.

Direct labour
Direct labour under this policy is labour cost directly charged to capital projects, including travel time incurred in getting to a work site and the return to the depot, and travel across multiple jobs.

Document control
As a minimum requirement, controlled documents will be identified by a unique number, be signed or noted as approved by the appropriate approving officer, have the current amendment number and approval date clearly displayed.

Employees who work with printed copies of documents must check the Business Management Systems (**BMS**) regularly to monitor version control. Documents are considered "UNCONTROLLED IF PRINTED", as indicated in the footer.

Executive Leadership Team (ELT)
Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Executive General Manager Emerging Energy Solutions, General Counsel and Company Secretary, Executive General Manager People and Culture, Executive General Manager Strategy and Regulation, Executive General Manager Transformation, General Manager Asset Management and Operations, General Manager Customer, General Manager Field Services, and General Manager Program Delivery.

Future economic benefits
The future economic benefits flowing from an asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity.

Labour on-costs
Labour on-costs are labour related costs representing the accrual of future leave or benefits to be taken, e.g. annual leave, sick leave, long service leave, superannuation and bonus.

Non-system assets
Non-system assets are physical assets not forming part of the entity's electricity distribution network, which include corporate land and building, furniture, office machines and photocopiers, plant and tools, radio equipment, telephones, computer equipment (eg personal computers, laptops, printers), computer hardware (and can only include the integral software which is required to operate the system), fleet and mobile phones.

Overheads
Overheads are costs other than the labour, materials and contracted services booked directly to capital projects. The vast majority of the entity's overheads are operations related and therefore expensed. The remaining overheads directly relate to the construction of assets and therefore, some portions of these costs are able to be capitalised via an allocation methodology. The following costs are specifically excluded from the total pool of allocations, eg advertising and promotional activities, staff training, research and development.

Phase
Phase is an electrical term given to a single electrical conductor. Three phases are required to provide a balanced electrical supply via a distribution overhead line or underground cable. In terms of capital and operating expenditure, all three phases must be replaced to meet the capitalisation criteria. If only one or two phases are replaced then the work is operating expenditure.

Pooled assets
Pooled assets are non-system assets that cost $500 or more but less than $1,000. These assets will not be individually accounted for in the Fixed Assets Systems. The pooled assets are fully depreciated in the month of purchase for accounting purposes but are depreciated on a declining balance rate of 37.5% for tax purposes.

Property, plant and equipment
Property, plant and equipment are tangible items that are:

- held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- expected to be used during more than one period.

Review date
The review date displayed in the header of the document is the future date for review of a document. The default period is three years from the date of approval. However a review may be mandated at any time where a need is identified due to changes in legislation, organisational changes, restructures, occurrence of an incident or changes in technology or work practice.

Span
A span is the term used to describe the distance between two poles designed to hold a set of electrical conductors. A span can be comprised of a single conductor or multiple conductors depending on the number of phases required to provide supply at that location.

System assets
System assets are those physical assets that form part of the entity's electricity distribution network which include land, buildings and equipment for transmission, sub-transmission and distribution assets.

5.0 KEY REQUIREMENTS

The entity will recognise the cost of a new item of property, plant and equipment as an asset if, and only if:

- it is probable that future economic benefits associated with the item will flow to the entity; and
- the cost of the item can be measured reliably.

Improvements to existing assets should only be capitalised where it is probable that future economic benefits greater than the originally assessed standard of performance of the asset will flow to the entity. This encompasses the service capacity, service quality and useful life.

Expenditure should be capitalised when it:

- enhances the economic benefits of the assets in excess of its previously assessed standard of performance;
- replaces or restores a component of the asset that has been treated separately for depreciation purposes and depreciated over its useful economic life;

- relates to a major overhaul that restores the economic benefits of the asset that have been consumed by the entity and has already been reflected in depreciation;
- will significantly reduce the ongoing maintenance costs of the asset; or
- will extend the service life of the asset beyond that expected when the asset was originally installed.

5.1 Cost of an item of property, plant and equipment

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

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

- any costs directly attributed to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; e.g.:

    - costs of employee benefits (as defined in AASB 119 Employee Benefits, including direct labour and labour on-costs) arising directly from the construction or acquisition of the item of property, plant and equipment;
    - costs of materials and contracted services;
    - a proportion of overhead allocated on the basis of labour hours;
    - costs of site preparation;
    - initial delivery and handling costs;
    - installation and assembly costs;
    - costs of testing whether the asset is functioning properly; and
    - professional fees (e.g. legal fees related to the purchase or construction of assets).

- the initial estimate of the (end of life) costs of dismantling and removing the items of the entire zone substation site and restoring the site on which they are located. This is an obligation which the entity incurs either when the item is acquired or as a consequence of having used the item. (Note: This cost will have to be measured in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent assets (paragraph 16 and 18));

- capitalised borrowing costs related to qualifying assets, (i.e. interest on the borrowings related to the construction cost of the asset which is greater than $10M and it takes more than twelve months to complete. Please refer to Finance Policy – Capitalisation of borrowing costs); and

- expenditure where a major component of an asset is replaced.

Please refer to Annexure A – Capitalisation Policy Application Guidance for examples of capital expenditure.

5.2 Costs that are <u>not</u> an item of property, plant and equipment

Costs incurred to keep a fixed asset in its normal operating condition that do not prolong the original useful life of the asset or increase the asset's future service potential, are not capitalised. These costs are expensed to the Income Statement when incurred.

The following costs are <u>not</u> included in the carrying amount of an item of property, plant and equipment:

- expenditure on design work not directly attributable to an asset;
- expenditure on inspection or maintenance work that will not add value to the assets or generate future economic benefits to the entity;

- expenditure on training staff to operate the asset;
- administration and other general overhead costs;
- additional costs incurred in using an item of asset while it is already in the location and a condition capable of operating in the manner intended by management, e.g. running costs;
- costs of relocating or reorganising part or all of the entity's operations;
- costs of opening a new facility (e.g. depots, buildings); and
- costs of introducing a new product or service (including costs of advertising and promotional activities).

5.3 Capitalisation threshold

The capitalisation threshold adopted by the entity is consistent with the Australian Taxation Interpretation. Generally, the costs of assets that form part of a project (e.g. computer system or office furniture) should be aggregated together when applying the capitalisation threshold tests.

The threshold limits are:

- Non-system assets with acquisition cost less than $500 should be charged as an operating expense in the month of acquisition; and
- Non-system assets that cost $500 or more but less than $1,000 should be capitalised as pooled assets.

Expenditure on the acquisition or construction of the following assets is capitalised regardless of cost:

- land;
- communication and telephone systems (excluding mobile phones); and
- system assets which increase the useful life or capacity of the distribution system.

5.4 De-recognition of work in progress

When a capital project is terminated before completion due to business reasons and the asset is not expected to generate any future economic benefits to the entity, the work in progress balance of the project should be de-recognised. If the capitalisation of project costs was authorised in the first place, any loss resulting in de-recognition of the work in progress should be treated as a write-off of assets.

6.0 ACTIONS TO ACHIEVE IMPLEMENTATION OF THIS POLICY

- Development or revision of procedures and systems to support operational compliance to this policy; and
- Communication of policy to all impacted areas.

7.0 AUTHORITIES AND RESPONSIBILITIES

Chief Executive Officer has the authority and responsibility for approving this policy.

Chief Financial Officer has the authority and responsibility for:

- endorsing this policy prior to Chief Executive Officer approval;
- implementing this policy within their division; and
- providing appropriate resources to support the management of this policy.

Head of Tax & Reporting has the authority and responsibility for:

- updating this policy; and
- monitoring adherence to this policy through the Management Representation Letter process.

Commercial Managers have the authority and responsibility for:

- reporting of any compliance issues; and
- providing accounting advice to divisions with respect to this policy.

Performance and Compliance Managers (Asset Management Division), Programme Co-ordination Manager (Network Services Division) have the authority and responsibility for:

- developing procedures within their area to comply with this policy; and
- advising their Commercial Managers of any compliance issues.

8.0 DOCUMENT CONTROL

Branch Manager	**:**	Head of Tax & Reporting
Content Coordinator	**:**	Financial Policy & Accounting Manager

Annexure A – Capitalisation Policy Application Guidance

Examples of system assets illustrating the application of this policy are listed below.

Capital expenditure

- Expenditure undertaken to replace old substation equipment, due to wear and tear in conjunction with augmentation work, should be treated as capital expenditure and the old assets should be disposed.
- Replacement of old system asset equipment including transformers under an identified "replacement program of work" should be treated as capital expenditure. Examples are obsolete or aged air break switches, regulators, pole top mains supporting cross arms, High Voltage (**HV**) Ring Main Isolators (**RMI**), Low Voltage (**LV**) boards, HV Circuit Breakers (**CB**) contained in the capital works planning replacement programs.
- Replacement of primary components of an asset which have a value greater than half the total value of that asset should be capital expenditure. An example would be a complete rewind of LV and HV windings of a transformer.
- Replacement of an essential component of the asset without which the primary asset could not function should be capital expenditure, e.g. a tap changer in a power transformer.
- Pole replacement under part of a major replacement program which extends the useful life of the system is capital expenditure.
- An underground cable failure is determined to require the replacement of a faulty joint and more than five metres of defective cable. The two new joints and over five metres of new cable should be capital expenditure. (Note: Where the cable fault is localised to a single cable joint which can be broken down and remade with less than five metres of new cable being used in the repair, it is operating expenditure.)
- An overhead line comprising all (three) phases of conductors in one or more spans which needs to be replaced to restore supply is regarded as a reactive replacement. This improves the capacity and therefore meets the capitalisation criteria as capital expenditure. (Note: Where the failure is restricted to one or two phase conductors in one or more spans requiring replacement to restore supply, is a repair and therefore is regarded as operating expenditure.)
- Provision of infrastructure assets such as cable tunnels and/or cable conduits which are used to support future electrical assets should be capital expenditure. The materials used to build, excavate, lay, backfill and reinstate these cable related assets are also capital expenditure. Note: The cable tunnel and conduits will often be a separate project installed prior to the cable installation project.
- Pole reinforcement of conditionally serviceable and unserviceable poles to restore the poles to a serviceable condition and can extend their life by an average of 5 to 15 years is capital expenditure. Not all poles are suitable for reinforcing. Poles are individually assessed to determine suitability for reinforcing in accordance with Network Standard NS145 'Pole Inspection and Treatment Procedures'.
- Storm and breakdown repairs which can be capitalised only when the assets are rebuilt to a higher standard, or destroyed assets are replaced by new assets. For example, where a length of overhead mains greater than 20 meters has been replaced; or where a complete overhead service has been replaced; or where multiple poles have been replaced. These mains and services are recorded on appropriate documentation to enable the amendment and updating of the GIS system with the date of installation (commissioning date).
- Expenditure associated with increasing operating temperature of overhead lines is capital expenditure. This often requires replacing insulators, replacing cross arms, replacing old poles

with new taller poles or increased numbers of poles, replacing poles with stronger structures for increased tensions, or conductor replacement.

- Connection and disconnection activities of temporary equipment necessary to maintain supply during the course of refurbishing or replacing a major asset are capital expenditure.

It should be noted the old assets replaced in any of the situations stated above will have to be retired from the assets registers.

Operating expenditure

- Replacing a component of an asset with like for like where the entire asset is not disposed of, is maintenance and should be included as operating expenditure.
- Replacement of a pole due to vehicle damage (e.g. pole is lying on the ground) is operating expenditure.
- Storm & breakdown repair is operating expenditure when the asset is repaired to the same standard as was the case prior to when the damage occurred. It can be capitalised only when the assets are rebuilt to a higher standard, or destroyed assets are replaced by new assets.
- Pole relocation by request of a third party should form part of the recoverable works and be expensed.
- Pole reinforcement is operating expenditure if no extension of life is achieved, typically for emergency situations to prevent imminent pole failure. Emergency pole reinforcement to prevent imminent pole failure is considered to be maintenance in nature as it ensures that the useful life expectations will be met and only provides a short term safety solution (typically less than 1 month).
- Painting pillars and kiosks, which can only improve the visual appearance of the assets, are operating expenditures.
- Where a cable fault is localised to a single cable joint which can be broken down and remade with less than five metres of new cable being used in the repair, this is operating expenditure.
- Where an overhead line failure is restricted to one or two phase conductors in one or more spans requiring replacement to restore supply, this is regarded as a repair and is operating expenditure.