

## Expenditure Capitalisation

**Summary:**

This standard sets out the guidelines for determining whether expenditure is capital in nature for TransGrid accounting record purposes and the responsibilities for ensuring transaction costs defined as “capital expenditure” are properly identified and recorded.

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When referring to TransGrid’s policies, frameworks, procedures or work instructions, please use the latest version published on the intranet.



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## 1. Purpose

This standard sets out the guidelines for determining whether expenditure is capital in nature for TransGrid accounting record purposes and the responsibilities for ensuring transaction costs defined as “capital expenditure” are properly identified and recorded.

TransGrid undertakes the following capital project processes:

- Major projects – augmentation;
- Major projects – asset replacement;
- Programs – asset replacement;
- Negotiated Transmission Service projects;
- Information Technology (IT) projects – software; and
- IT projects – hardware.

The process maps attached to this procedure may be used as guidance when determining whether expenditure is capital or operating in nature for each of the above capital projects.

## 2. Scope

This procedure applies to all TransGrid staff involved in the expenditure capitalisation.

## 3. Definitions

Insert key definitions and terms relating to compliance with legislation and ISO Standards.

Asset	The definition of an asset under Australian Accounting Standards is “ <i>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</i> ”
Asset recognition	Australian Accounting Standards state that an asset shall only be recognised if, and only if: <ul style="list-style-type: none"> <li>• “<i>It is probable that the future economic benefits associated with the item will flow to the entity; and</i>”</li> <li>• <i>The cost of the item can be measured reliably</i>”</li> </ul>

## 4. Procedure

The following sections provide guidance on the requirements for the different stages of capitalisation.

### 4.1. Initial Acquisition

#### 4.1.1. Classification

The initial costs to acquire or construct an asset may relate to:

- The acquisition or construction of a new asset;
- The installation of a new asset; and
- Work performed on an asset, where the need for the work existed at the time the unit was acquired and the work was carried out prior to it being put into operation.

If a second hand asset is purchased, it is possible for costs associated with the following activities to be capitalised:

- Improving the condition or functionality of the asset to meet TransGrid's standards; and
- Replacing aspects of the asset that has reached the end of its operational life.

### 4.1.2. Capitalisation Threshold

Physical non-current assets or parts of an asset costing less than \$3,000 are to be recorded against the Miscellaneous Operating Project 3502 – Low Value Asset Pool and expensed immediately. Refer to the “*Asset Recording and Control Procedure*” GD FN G2 018 for further guidance on Instant Assets and the Low Value Asset Pool.

## 4.2. Subsequent Costs

Under Australian Accounting Standards subsequent costs must be evaluated under the recognition criteria outlined above. Subsequent costs that replace, add to, or enhance an asset that has already been commissioned for TransGrid use may be capitalised where it meets the following criteria;

### 4.2.1. Addition or Replacement

An addition to an asset may be capitalised.

Replacement of an asset or a substantial part of an asset may be capitalised. Replacement of part of an asset is considered to be substantial where the expenditure results in an extension in the unit's pre-determined useful life. As a guide, a substantial part of an asset represents 40% or more of either the total:

- Value of the asset; or
- Physical components comprising the asset.

The following are examples of the type of expenditure that falls into this category:

- Replacement of a circuit breaker in a switchbay;
- Replacement of transmission wood poles undertaken as part of a structured program within a defined period of time (2 to 3 years) where the total costs of the replacement work represent 40% or more of the value of the transmission line, or the replacement work was undertaken on 40% or more of the physical asset;
- Where disconnector replacements are part of works that result in the replacement of a substantial part of a switchbay;
- Replacement of a primary protection relay on a panel;



- A package of work on a unit of plant, which directly results in an extension to the unit's pre-determined useful life by 10 years or more. This work would not be required again during the life extension period; or
- Replacement of a server used as part of an operating system.

## 4.2.2. Enhancement

A significant improvement to an asset's overall design rather than restoring an asset to its original condition. An improvement means that the asset now has one of the following characteristics;

### 4.2.2.1. Effective and material increase in service capacity

Expenditure which increases an item's service capacity is accounted for as an enhancement. The increase in capacity must be both effective and material.

An increase in service capacity is effective if it meets increases in demand. If the increase is only incidental to the necessary maintenance of the existing service capacity or the additional capacity will not actually be used in the foreseeable future, then the expenditure is to be classified as operating in nature.

### 4.2.2.2. Effective and material increase in service quality

Improvement in the quality or standard of service provided represents an enhancement to an asset. The enhancement in quality must be effective and material.

### 4.2.2.3. Extended useful life

Subsequent costs may only be accounted for as an enhancement if they effectively and materially increase the asset's pre-determined useful life. It is important to distinguish this type of capital expenditure from maintenance expenditure that is only aimed at ensuring the achievement of the asset's pre-determined useful life, or simply sustaining the asset's operational level.

Capital expenditure may involve the use of internal labour or material resources, or services from an external source.

## 4.3. Capital Project Expenditure Classification

The process maps shown in Attachments 1-4 of this document show the classification of capital project expenditure.

The principles underlying when capitalisation may commence for each capital project type are as follows:

- Major capital works, Asset Replacement Programs, IT hardware projects: Expenditure associated with the evaluation of a narrow range of options leading to a recommendation of a preferred option may be capitalised.
- Negotiated Transmission Service projects: Following TransGrid and our customer signing the Offer to Connect contract for the provision of the negotiated transmission service.

- IT software projects: Expenditure may be capitalised after all project options have been evaluated and the final selection of possible alternatives has approved.

## 4.4. Financial Close

Project numbers associated with a Capital project will remain open for a period of four months from completion of the commissioning period. This will allow outstanding contractor claims, finalisation of field works and other minor project associated activities to be completed.

After the four month timeframe, further costs incurred must relate to activities identified at or before the time of commissioning to be capitalised. Monitoring of projects and their status is to be undertaken by the Assets team.

## 4.5. Components of Capital Expenditure

### 4.5.1. Constructed Assets - Direct Expenditure

Costs for labour, materials and external services directly attributable to a specific capital project, and incurred up to the completion of the commissioning period of the project, are capitalised to the relevant Capital Project as part of the project costs. These costs must form part of a systematic and planned activity of the project.

Examples of capitalised costs are;

- Development of Project Plans, design work, construction, commissioning and associated construction costs;
- Costs to obtain regulatory approval for the project;
- Environmental assessment costs;
- Activities undertaken to meet environmental conditions of approval for construction purposes;
- Land and easement acquisitions;
- Project Office set-up costs and project management costs including meetings attended to discuss the project;
- Running costs of motor vehicles and mobile plant used wholly in the capital project;
- User acceptance testing and implementation;
- Establishment of operating manuals and support documentation prior to asset commissioning; and
- Expenditure associated with the fulfilment of specific conditions of development applications and environmental approvals.

Examples of costs that should not be capitalised as part of the project costs are:

- × Post-implementation project review costs;
- × Costs associated with updating designs and drawings not completed within four months of the completion of commissioning;
- × Acquisition costs of Instant Assets that are not to be exclusively used for that capital project; or

- × Costs associated with routine inspections of plant and equipment undertaken post-commissioning during the defects liability period.

### 4.5.2. Constructed Assets - Interest during Construction

Borrowing costs incurred on funds borrowed for acquiring, constructing or producing an asset are to be capitalised to that asset in accordance with the *Interest During Construction* procedure GD FN G2 036.

### 4.5.3. Information Technology (IT) Expenditure

Information Technology expenditure shall only be capitalised where it meets the following criteria:

- The capital project must be capable of being broken down into properly definable assets with appropriate effective lives.
- In regards to IT assets the following activities are examples of capital expenditure;
  - Business case preparation for hardware projects;
  - Short form business case preparation for software projects (short form business cases are prepared for replacements and upgrades – no options evaluated);
  - Tendering and procurement;
  - Development of prototypes/pilots;
  - Purchase of software licenses;
  - User acceptance testing;
  - Creation of operating manuals and support documentation prior to system go-live; and
  - Project management associated with the above activities.
- Expenditure incurred on the following activities should be treated as operating in nature;
  - Business case preparation for software projects (business cases are prepared where more than one option is evaluated);
  - Software maintenance and support;
  - Training of staff to use and operate the IT asset including co-ordination and delivery of training and labour; and
  - Post implementation and benefits reviews.
- Costs associated with a general system review which is undertaken to assess current operating capabilities and potential areas for improvement are to be expensed, as there are no definable assets arising from the process.
- Costs in relation to software installation, ongoing maintenance and support must be properly segregated. For example, where a lump sum payment is made to cover the licence fees for installation of the software, as well as upfront payment for maintenance charges, the latter must be identified and expensed, rather than capitalised.

- Research or investigation costs in relation to internally generated computer software must be expensed. Where this research results in the development of internally generated computer software, only the development costs are considered as capital expenditure if they meet the requirements of this procedure.

## 4.6. Litigation Costs

Disputes may arise with contractors during the course of capital works construction contracts. Legal action may be brought about by the contractor or TransGrid to resolve these disputes. Advice relating to the accounting treatment of the related legal expenditure and damages paid or received should be sought from the Financial Controller.

The appropriate classification of legal expenses incurred and damages paid or received associated with such disputes will be considered on a case by case basis. The following factors are considered when determining the nature of litigation expenditure and monies received:

- If the dispute is in relation to an asset defect:
  - whether the defect was present when the asset was commissioned; and
  - the timing of the defect being identified in relation to the useful life of the asset;
- Nature of the claim i.e. whether the claim relates to:
  - loss of the contractor's income; or
  - increased maintenance costs being borne by TransGrid due to a defective asset; or
  - an adjustment of the contract value.
- Nature of the settlement awarded; and
- How successful TransGrid was in pursuing a claim against a contractor or defending a claim made by a contractor against TransGrid.

## 5. Accountability

Financial Controller	<ul style="list-style-type: none"> <li>• Ensuring TransGrid's expenditure capitalisation procedure is current and complies with accounting and tax legislative requirements where applicable;</li> <li>• Providing advice to the Information and Communication Technology (ICT) group as to the appropriate classification of expenditure included within IT project briefs i.e. capital or operating in nature; and</li> <li>• Providing advice to Business Managers as required in respect to the classification of expenditure as either capital or operating in nature.</li> </ul>
Business Managers	<ul style="list-style-type: none"> <li>• Classifying expenditure within their Business Units as either capital or operating in nature and seeking advice from the Financial Controller as required.</li> </ul>

## 6. Implementation

Insert how the procedure will be implemented. Include a diagram where possible.

## 7. Monitoring and review

Insert how the procedure will be monitored and reviewed, inclusive of any management review.

## 8. Change history

Revision no	Approved by	Amendment
4	Tony Meehan, EGM/FIS	<ul style="list-style-type: none"> <li>• Changes to the expenditure starting point for major capital works.</li> <li>• Removal of the following content from this procedure which has now been included in the <i>Asset Recording and Control Procedure</i> GD FN G2 018: <ul style="list-style-type: none"> <li>○ Various responsibilities relating to asset recording and control processes;</li> <li>○ Asset unitisation table; and</li> <li>○ Guidance on the determination of an asset's useful life.</li> </ul> </li> <li>• Position titles and descriptions updated to reflect the current organisational structure.</li> <li>• Removal of the requirement for software purchases to be over \$10,000 and have a useful life in excess of two years in order for them to qualify as assets.</li> <li>• Addition of "Litigation" section.</li> <li>• Addition of project process maps depicting those activities which are capital or operating in nature.</li> </ul>
4	Not required	Minor alteration to wording in section 4.4

## 9. References

- *Asset Recording and Control Procedure*
- *Interest During Construction*
- *Corporate Governance Framework for Expenditure on Major Capital Works Projects*
- NSW Treasury Policy Paper TPP 06-6 *Guidelines for capitalisation of expenditure on property, plant and equipment*
- AASB 116 *Property, Plant and Equipment*
- AASB 138 *Intangible Assets*
- AASB 123 *Borrowing Costs*



## 10. Attachments

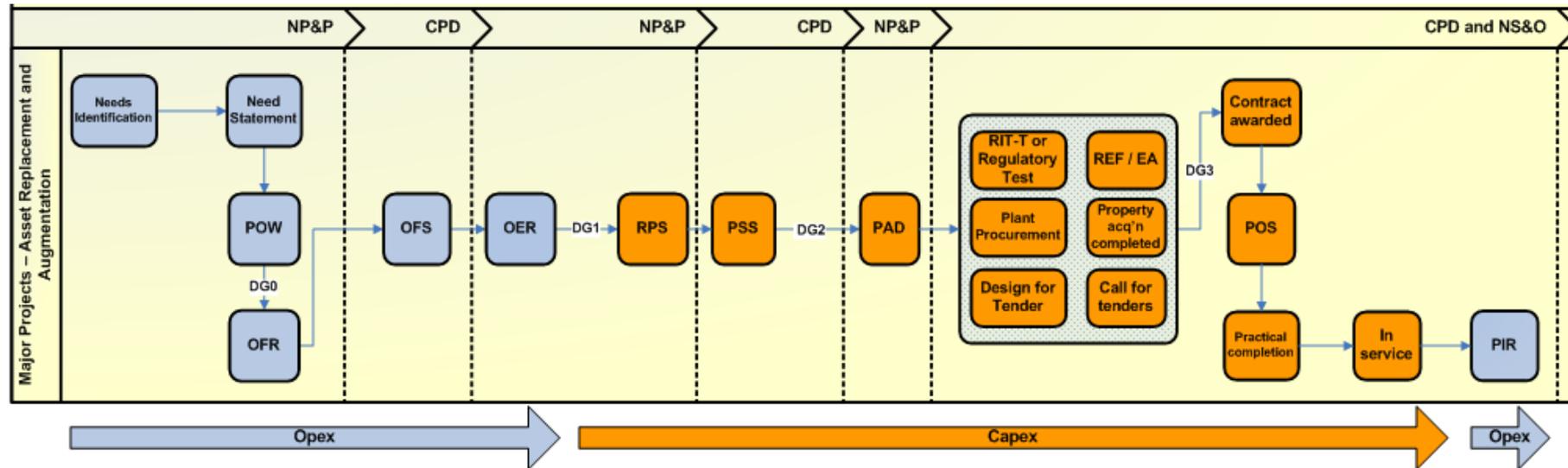
Attachment 1 – Major Capital Projects Process Map – Augmentation and Replacement

Attachment 2 – Asset Replacement Programs

Attachment 3 – IT Projects – Hardware and Software

Attachment 4 – Negotiated Transmission Services Projects

## Attachment 1 – Process Map

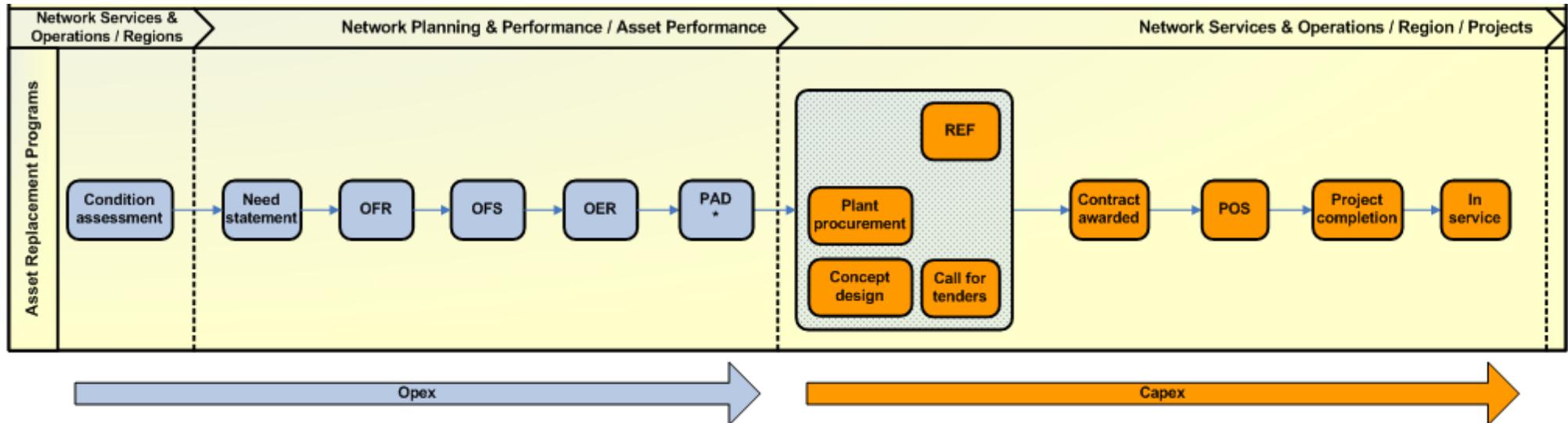


### Abbreviations

POW: Program of Work  
 OFR: Options Feasibility Request  
 OFS: Option Feasibility Study  
 OER: Options Evaluation Report  
 RPS: Request for Project Scoping  
 PSS: Project Scoping Study  
 PAD: Project Approval Document  
 RIT-T: Regulatory Investment Test for Transmission  
 REF: Review of Environmental Factors

EA: Environmental Approval  
 DG0: Planning Funds Approval  
 DG1: Project Commencement  
 DG2: Project Determination  
 DG3: Financial & Contractual Commitment  
 POS: Possession of Site  
 PIR: Post Implementation Review

## Attachment 2 - Asset Replacement Programs – Capex / Opex Treatment



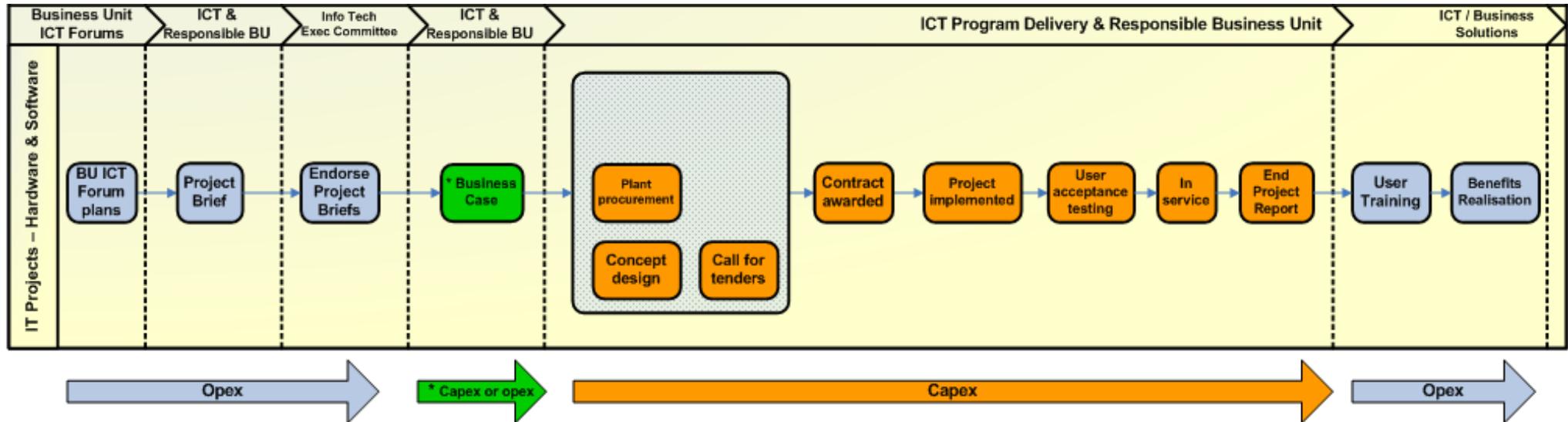
### Abbreviations

- OFR: Option Feasibility Request
- OFS: Option Feasibility Study
- OER: Options Evaluation Report
- PAD: Project Approval Document
- REF: Review of Environmental Factors
- POS: Possession of Site

### \* Note

The purpose of the Project Approval Document is to approve the asset replacement program. Each program comprises of many asset replacement capital projects. Expenditure relating to the creation of PADs are reallocated to asset replacement capital projects via TransGrid's support cost reallocation process.

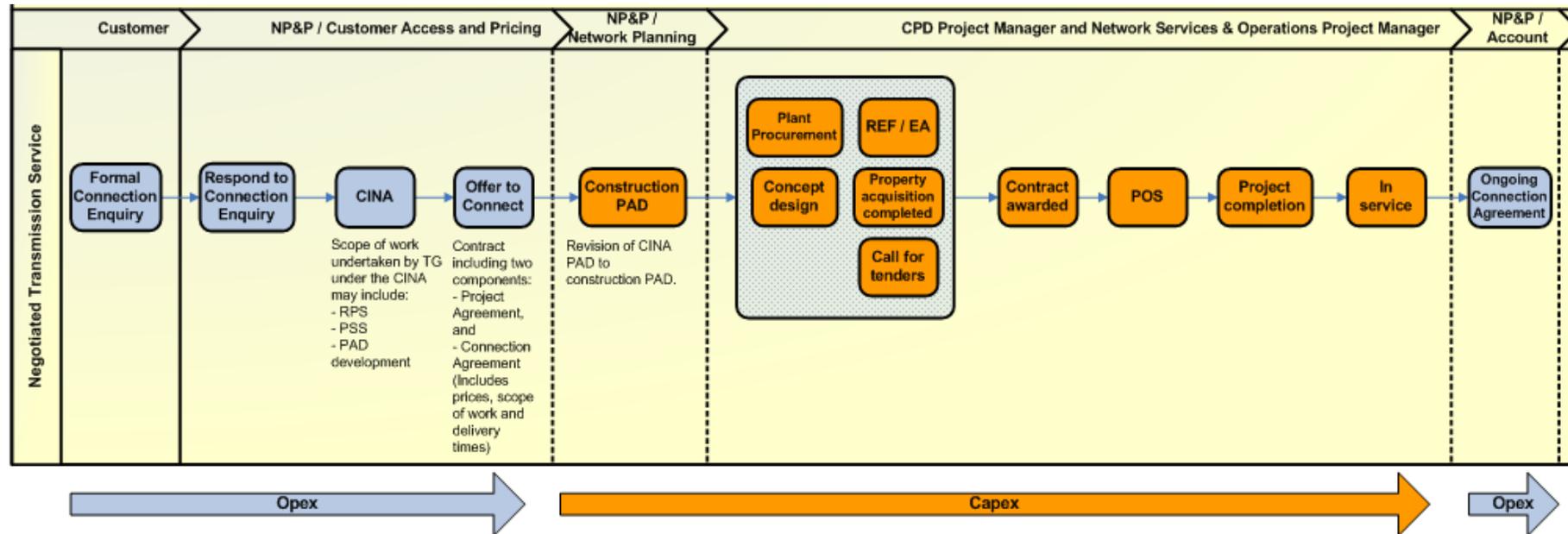
### Attachment 3 - IT Projects – Hardware & Software – Capex / Opex Treatment



**\* Note:**

- Business case preparation for **all** IT hardware projects represents capital expenditure.
- Short form business case preparation for software projects represents capital expenditure (short form business cases prepared for replacements and upgrades – no options evaluated).
- Business case preparation for software projects represents operating expenditure (full business cases prepared where 2 or more project options are evaluated).

## Attachment 4 - Negotiated Transmission Services – Capex / Opex Treatment



### Abbreviations

CINA: Connection Investigation and Negotiation Agreement  
 RPS: Request for Project Scoping  
 PSS: Project Scoping Study  
 PAD: Project Approval Document  
 REF: Review of Environmental Factors  
 EA: Environmental approval  
 POS: Possession of Site