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Note presenting Opinion n° 2012–02 of 4 May 2012 relating to the conditions of initial recognition of tangible assets previously not recognised due to particular situations

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MINISTÈRE DU BUDGET
DES COMPTES PUBLICS
ET DE LA RÉFORME DE L'ÉTAT

1. Background

By letter dated the 5th of September 2011, the Public Finances General Directorate ("DGFiP") referred the issue of the conditions of initial recognition in the accounts of all national public establishments ("*établissements publics nationaux*" – "EPN") of tangible assets not previously recognised due to particular situations to the Public Sector Accounting Standards Council ("*Conseil de normalisation des comptes publics*" – "CNoCP").

This referral followed an initial study carried out by the Public Sector Accounting Standards Council in April 2011 in response to issues raised by the board of auditors of "Voies Navigables de France" in relation to the accounts for 2010 with reference to the initial recognition of public domain assets which the Central Government has entrusted to the entity. These issues were raised both with the Public Sector Accounting Standards Council ("*Conseil de normalisation des comptes publics*") and the Accounting Standards Authority ("*Autorité des normes comptables*" – "ANC").

Furthermore, paragraph IV of the circular of 28 February 2007 relating to the modernisation of the management of State property published in the Official Journal of 3 March 2007 defines the strategy decided by the French government in the specific case of operators'[1] property. This strategy is mandatory for all national public establishments and necessitates the amendment of the general accounting requirements for tangible assets.

2. Scope

2.1 Entities concerned

The Opinion applies specifically to:

- Public establishments, in particular those within the scope of budgetary, financial and accounting instructions M9-1 (public establishments of an administrative nature), M9-2 (chambers of agriculture), M9-3 (public establishments of a scientific, cultural or professional nature), M9-4 (public establishments for the planning of new towns), M9-5 (public establishments of an industrial and

[1] Circular of 28 February 2007, § 4: "The Government has decided to lay down the foundations of a strategy for public property management applicable to state-controlled organisations carrying out a public service mission. (1). Initially, it shall include a survey and valuation of property available to public establishments. This survey, which in 2006 covered the 50 establishments identified as holding the most significant assets, will be extended to cover a further 223 establishments in 2007 and will cover all such establishments by 2009. The cooperation of all the organisations concerned by this task is essential."

commercial nature), M9-51 (public land agencies), M9-7 (public establishments for promoting cultural activities abroad), M9-9 (local authorities for teaching and professional training in agriculture), M9-10 (national public establishments for teaching and professional training in agriculture) and M21 (public health institutions)

- Regional and local authorities
- Other public entities (chambers of trade and crafts, etc.).

In practice, the provisions of the Opinion should not effectively apply to the Central Government because its accounts were upgraded during the preparation of its opening balance sheet on the 1st January 2006. This Opinion does not therefore affect the value of those assets recognised in compliance with the transitional provisions of Standard 6 of the Government Accounting Standards Manual (“*Recueil des normes comptables de d’Etat*” – “RNCE”). Nevertheless, in order to ensure the consistency of accounting standards applicable within the public sector, the Central Government is within the scope of the Opinion.

The provisions of the Opinion should not apply to social security organisations either, as in most cases they have already implemented an upgrading of their accounts and because their assets are not material.

2.2 Approach adopted

The Council defined the scope of the Opinion by reference to particular situations it identified that could lead a public sector entity to recognise for the first time tangible assets that were not previously recognised in its accounts as a one-off accounting adjustment, within a restricted time frame.

The Council rejected a scope definition based on tangible asset classes. This decision is based on the fact that different classes of tangible assets have enough common characteristics to justify a global approach. It is more the situations encountered by public sector entities that are of a particular nature. Therefore, a list of the different situations to be considered was drawn up with a view to defining the scope of the Opinion. In parallel a list of scope exclusions was also drawn up.

The Opinion has general application subject to exceptions that may exist in other accounting regulations. This may be the case of “historical and cultural assets” for which specific provisions may exist on initial recognition.

2.3 Situations within the scope

The Opinion relates to the conditions of initial recognition of tangible assets previously not recognised in the accounts of public sector entities as a one-off accounting adjustment in the two following particular situations.

2.3.1 Assets that are inventoried but not recognised

The first situation to be considered is that of inventoried tangible assets that are not recognised because their acquisition cost is unknown or for which no valuation is available so that it is not possible to recognise them under current accounting requirements.

(a) This situation covers tangible assets which the entity has not recognised because the relevant recognition criteria are not met.

Both the General Chart of Accounts[2] and international accounting standards stipulate that an asset shall only be recognised if its cost can be measured reliably.

This reliability condition is implicit rather than explicit in the current version of the Government Accounting Standards Manual. Paragraph II.1 – Measurement on Initial Recognition of the Introduction to Standard 6 refers implicitly to this condition: “On initial recognition the usual business accounting rules can be transposed for the measurement of the Government’s tangible assets”, usual business accounting rules which refer explicitly to that condition (see above).

(b) This situation includes both tangible assets inventoried but not recognised and partially recognised inventoried tangible assets. The latter situation arises, for example, when the assets have never been recognised in the accounts of a public sector entity except for those works carried out by that entity (extensions, development costs, etc.).

(c) Assets that have been transferred in the past to a “receiving” entity which for practical reasons was unable to recognise them are also within the scope of the Opinion. Indeed, past agreements covering the transfer of assets between public sector entities were often of a global nature and did not always give details of the value of the assets and/or gave incomplete information about them. In this case, the establishments have to carry out a valuation and/or a complete inventory of the relevant assets before recognising them in their accounts (see § 2.3.2 below). Future transfers between public sector entities are not within the scope of the Opinion (see § 2.3.3 a) (iii) below) because they are not exceptional situations requiring accounting adjustment.

[2] See article 311-1 of the General Chart of Accounts and section 2.3.1 of Instruction n° 06-007-M9 of 23 January 2006.

2.3.2 Assets recently inventoried as part of a self-initiated plan

The second situation relates to tangible assets which have been recently inventoried as part of a plan within a restricted time frame to upgrade the accounts after a full inventory of all assets, including when this is carried out at the entity's initiative. This occurs, for example, when public health institutions implement a plan to upgrade their accounts and make them more reliable or when public sector entities prepare their first audited accounts.

The Opinion is applicable when this plan is complemented by reliable valuations of the assets so as to enable their recognition in the accounts (see § 2.3.1 above).

2.3.3 Situations outside the scope

In contrast to the two particular situations identified above in paragraphs 2.3.1 and 2.3.2, the following are excluded from the scope of the Opinion.

(a) Initial recognition not directly related to the determination of a reliable valuation of the asset

(i) Acquisitions of tangible assets in the course of the everyday activities of public sector entities are not within the scope of the Opinion which includes only the two above-mentioned particular situations (see§ 2.3.1and § 2.3.2). The accounting treatment of these acquisitions is determined by reference to the relevant accounting requirements applicable to those entities.

(ii) The same applies to assets engaged in a public service arrangement, and more specifically to assets constructed by the operator that revert to the grantor at the term of the concession arrangement. This specific situation is dealt with by CNoCP Opinion n° 2011-11 of 8 December 2011 relating to the treatment of contracts for the provision of public services in the accounts of public entities.

(iii) Transfers of assets between public sector entities (including the return of assets to the "lending" entity under use agreements) are not within the scope of the Opinion because they do not constitute exceptional situations requiring accounting adjustment.

(b) Assets already recognised by the public sector entity

(i) The measurement subsequent to initial recognition of tangible assets for which transactions within the scope of the Opinion have taken place (for example, measurement on the reporting date and depreciation, etc.) is carried out according to the provisions in the relevant accounting standards applicable to the entities concerned. Thus, adjustments consequential to the lack of reliable valuation (for example, no distinction between land and

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buildings or unreliable initial measurement due to obvious estimation errors) are not within the scope of the Opinion as they constitute the correction of errors.

(ii) The effects of the legal harmonisation of Central Government agreements with national public establishments (assets previously allocated that are reclassified under new use agreements) are not within the scope of this Opinion.

(c) Assets identified during the annual physical inventory

The tangible assets previously omitted from an entity's balance sheet that are identified on an isolated one-off basis during its routine annual physical inventory [3] are also outside the scope of the Opinion. They constitute omissions that fall within the scope of the correction of errors.

3. Measurement of the tangible asset on initial recognition

3.1 Entry values in the identified situations

Tangible assets that are inventoried but not recognised or recently inventoried as part of a plan within the scope of the Opinion are generally acquired free of charge. These assets usually come from previous transfers which for different reasons the receiving entity has not recognised (not required by previous accounting rules, measurement difficulties, etc.).

Under current accounting regulations[4] the entry value for assets acquired free of charge is net selling price.

On initial recognition, tangible assets within the scope of the Opinion are recognised at net selling price, which by convention is deemed to be their historical cost.

The net selling price[5] is the amount that could be obtained for the sale of an asset in an arm's length transaction, less disposal costs[6].

Nevertheless, in those exceptional circumstances where the net selling price cannot be determined reliably, tangible assets are measured at replacement cost (see § 3.2 below).

[3] See article L 123-12, sub-section 2 of the Commercial Code.

[4] See article L123-18 of the Commercial Code and article 321-1 of the General Chart of Accounts.

[5] Source: Glossary of the Government Accounting Standards Manual.

[6] Costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense if applicable.

3.2 Exceptional cases where replacement cost is used

Those specific assets for which no directly identifiable net selling price exists (in exceptional cases, as measurement at net selling price is to be preferred) are measured at replacement cost.

Replacement cost is based on an estimation of the cost of a similar asset with an identical service potential. It is the Council's opinion that current replacement cost[7] is not the appropriate measurement base.

By analogy with Opinion n°2003-E of the CNC's urgent issue committee of 9 July 2003, replacement cost may be determined either be reconstituting the historical cost of the replaced components using the original invoices, or by methods using technical data based on the allocation of the current cost of a new asset or by using the observed price for recent or renovated assets, adjusted as necessary to take account of economic and technical change. The amount of depreciation which should have been recognised is then calculated over the different useful lives.

The Council rejects the first solution (reconstitution of the historical cost) considering the particular circumstances relating to the assets within the scope of the Opinion (see § 2.3 above).

It is stressed that the replacement cost is recognised net, which by convention is deemed to be historical cost.

The exceptional cases where net selling price is not applicable relate in principle to specific assets for which the relevant price cannot be determined reliably, is not directly identifiable or is unknown due to the lack of an active market[8] or because these assets are rarely sold. These assets generally have a specific measurable service potential.

Examples of these exceptional cases include a dam, a lock or a space launch pad.

3.3 Exceptional cases where it is impossible to determine a reliable entry value

In those cases, which must remain exceptional, where it is not possible to determine a reliable entry value (net selling price or replacement cost), the assets concerned will

[7] The cost the public entity would incur to acquire the asset at the reporting date (source: Glossary of the Government Accounting Standards Manual).

[8] Market in which the items traded are homogenous, willing buyers and sellers can normally be found at any time and prices are available to the public (source : Glossary of the Government Accounting Standards Manual).

nevertheless be recognised in the accounts. For practical reasons, the asset may be measured at a token value of one euro, the aim being to ensure the reliability of the information included in the financial statements by presenting a complete view of the assets held by the reporting entity as part of an on-going process undertaken by the Central Government.

In addition, appropriate disclosure is made in the notes to the financial statements indicating in particular why it is impossible for the entity to determine an entry value.

3.4 Specific case of assets for which the historic cost is unknown and which have significant symbolic value

Even if this Opinion does not set out to define measurement bases by class of asset, where public sector entities have no intention of selling property or non-property assets for which no historical cost is known and which have a significant symbolic value, the latter assets shall nevertheless be recognised in the accounts (albeit for the token amount of one euro, see above). This applies to historical monuments (cathedrals, castles, etc.) or works of art (paintings, sculptures, etc.) which are not for sale. These same property and non-property assets are also recognised in the accounts if they are saleable (and even if their acquisition cost is unknown). In this case, there is an issue as to whether a token value of one euro is relevant. The Council for Public Sector Accounting Standards is giving further consideration to this issue.

3.5 Date for determining and recognising the entry value

The date for recognising assets within the scope of the Opinion is defined by convention as the last day of the period in which the relevant assets are recognised (reporting date).

In view of the practical difficulties which public sector entities are faced with, the Council considers that valuations carried out in the period prior to that in which the assets are recognised are acceptable as entry values, provided that the entity ensures that the values are not significantly different to those that would have been obtained in the period of recognition.

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3.6 Specific treatment of partly recognised tangible assets

When an asset within the scope of the Opinion has been partly recognised (see § 2.3.1 (b) above), the difference between the total entry value of the asset and the amounts previously recognised is accounted for as an asset without modifying the treatment of the part already recognised (similar to the "components approach").

3.7 Specific treatment of major maintenance expense

The treatment of major maintenance expense is dealt with under existing accounting rules[9].

Where the rules relating to provisions for major maintenance apply, the public sector entities that recognise such provisions shall, where applicable, set up provisions for the assets included in the scope of the accounting adjustment.

When this accounting adjustment is recorded, the corresponding provisions for major maintenance are recognised with a balancing entry in account 11 "Accumulated surplus/deficit brought forward" [10] for an amount based on the major maintenance schedule at the date of the adjustment. The amount of the provision is the portion of total scheduled maintenance expense relating to past periods (period of accrual) determined on a straight-line basis.

The accounting treatment of any existing provisions for major maintenance already recognised by the entity is not affected and remains unchanged.

The public sector entities which apply the "components approach" shall recognise, for those assets within the scope of the accounting adjustment, a major maintenance component as part of the entry value of the relevant assets. In principle the latter includes a proportion of major maintenance to be incurred in the future, the amount of which depends on the accrued interval between maintenance dates when the accounting adjustment takes place. This component does not increase the entry value of the underlying asset. It is one of its

[9] According to article 311-2 of the General Chart of Accounts, expense relating to major maintenance and inspections may be recognised, at the entity's option, either as a provision for major maintenance and inspections, or as components (According to the Opinion of the CNC's Urgent Issue Committee n°2003-E, §4, the same accounting treatment must be adopted for all fixed assets). The expense within the definition of provisions for major maintenance and inspections is maintenance expense (General Chart of Accounts, art. 311-2 and CNC Opinion n°2000-01, §5.10) (i) which forms part of a pluriannual programme in compliance with the law, regulations and the usual policy of the entity, (ii) and of which the sole objective is to maintain the installations in working order (for example, security maintenance for aircraft) and to service them (for example, maintenance of the hull of ships) without increasing their initially expected lifespan. However, major maintenance and repairs do not include expense intended to modify the installations or to increase their useful life (which meets the definition of fixed assets), and the replacement of components (which are also components).

[10] Consistent with the requirements for the first application of regulation n°2002.10 of the Accounting Regulation Committee relating to the depreciation and impairment of assets (article 15-1)

components. As an exception, no major maintenance component is recognised for those assets which have a token carrying value of one euro at the date of the accounting adjustment.

The major maintenance component is measured as the net amount determined at the date of the accounting adjustment by estimating future maintenance expense less the depreciation which should have been recognised for the component at that date. It is subsequently depreciated over the residual period outstanding up until the scheduled date for major maintenance.

Example

The following example provides an illustration of the two above-mentioned accounting approaches. It relates to major maintenance to the hull of a ship required to obtain a navigation certificate. The expense at the date of the accounting adjustment is estimated at 50 K€ and occurs every five years. For the sake of the example, the accounting adjustment takes place at the end of year 3, two years before the next maintenance is scheduled.

Recognition of a provision for major maintenance

Provision for major maintenance at end of year 3: 30 K€ (50 K€ x 3years/5years) with the balancing entry in "Accumulated surplus/deficit brought forward"

Recognition of a component for major maintenance

Component for major maintenance in year 3: gross amount 50 K€ less depreciation of 30 K€ (50 K€ x 3 years/5 years) which would have been recognised at the date of the accounting adjustment if the ship had been recognised as an asset of the entity, which leaves a net amount of 20 K€ recognised as part of the entry value.

The major maintenance component amounts to 20 K€ at the date of the accounting adjustment and is one of the components of the net selling price of the underlying asset.

4. Recognition of the balancing entry for the tangible asset

The balancing entry for the tangible asset is recognised in net assets/equity.

The presentation of the equity accounts of national public establishments shows the sources of external funding relating to controlled assets. Thus Central Government funding (#10) and external Non-Central Government funding (#13) are presented separately[11]. In addition, these two items are further broken down between contributions that are related to a defined asset and those that are not. The allocation of a source of funding to an asset is carried out on initial recognition.

In the exceptional cases where the identity of the contributor of the asset cannot be determined, the asset cannot be allocated to the source of funding. Its entry value is then recorded in account 11 “Accumulated surplus/deficit brought forward”.

Where partially recognised tangible assets (see § 2.3.1 (b) above) are allocated to a source of funding, the initial accounting treatment for the latter is not affected and remains unchanged.

5. Presentation and disclosure

5.1 Presentation of the accounts

The Opinion does not contain any specific requirement relating to the presentation of assets and liabilities arising from the application of these accounting adjustments. The latter are recognised under the balance sheet headings to which they relate.

5.2 Accounting policies

The notes provide a description of the accounting policies applied to the assets and liabilities relating to tangible assets within the scope of the Opinion, in particular with respect to the determination of entry value.

[11] Source: CNoCP Opinion n° 2011-10 of 8 December 2011 relating to the presentation and recognition of the funding of public establishment assets.

5.3 Accounting information

As the assets concerned are included in the different classes of tangible assets, at the foot of the tables presenting changes in gross value and depreciation, the opening and closing amounts relating to these assets are disclosed for each period.

The information on the changes in net assets/equity during the period discloses amounts recognised directly in net assets/equity during the period for tangible assets within the scope of the Opinion.

5.4 Other information

An entity wishing to benefit from the specific provisions set out in paragraph 6 of the Opinion shall make the disclosure in the notes required by that paragraph.

6. Qualification of the change

The provisions of the Opinion do not constitute a change in accounting policy, a correction of errors, or a change in accounting estimate. The Opinion applies to particular situations encountered that form part of an accounting adjustment within a restricted time frame and relates to tangible assets not previously recognised by the public sector entities.

The Council does not consider that retrospective application would be relevant in the circumstances. As a simplification[12], this Opinion applies prospectively to the accounts of the public entities concerned.

Consequently, the Opinion applies to accounting adjustments that will take place after it comes into force, including when these adjustments refer wholly or partly to tangible assets acquired before it came into force but were not recognised in the accounts or only partly recognised.

For the same reasons, the Council considers that the situations within the scope of the Opinion should not give rise to restatement of the accounts of public sector entities in respect of tangible assets which would otherwise have been recognised prior to it coming into force.

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[12] By reference to what has been done in respect of the first application of rules relating to assets in the accounts of private sector entities.

7. Effective date and specific provisions

The Public Sector Accounting Standards Council is of the opinion that the provisions relating to the initial recognition of tangible assets not previously recognised due to the two particular situations within the scope of the Opinion should be applied immediately.

In order to take account of the difficulties of public sector entities in obtaining full information on the existence and/or the measurement of assets and in order to enable the necessary information to be gathered, the Public Sector Accounting Standards Council allows the application of the Opinion to be spread over a period not exceeding 5 years, considering that it is a one-off accounting adjustment affecting a large number of assets. This period begins on the date when the public sector entity first recognises an asset within the scope of the two situations in the Opinion. Nevertheless, in order to ensure the understandability of the financial statements, the Council considers it would be preferable if, as far as possible, this period did not exceed 2 accounting periods.

The accounting adjustments enable a public sector entity to recognise all the assets it previously omitted from its accounts which are its property. The progressive application period is designed to enable all the necessary information to be gathered and ultimately it should in no circumstances lead to an incomplete adjustment.

An entity which wishes to benefit from this progressive application period must nevertheless recognise all the tangible assets belonging to the same class (land, property, etc.) or, if applicable, belonging to the same geographical zone (region, etc.) in the same accounting period. It discloses the relevant classes of assets/geographical zones and mentions those still requiring adjustment.

In addition, the entry values recognised may not be modified subsequently except to correct an error. In this case, the appropriate accounting treatment will be that applicable to the correction of errors.