



NCP 5 – Tangible Fixed Assets: Study Application Case in Portugal

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ABSTRACT

2015 saw an important step in the accounting reform in Portugal. On September 11, 2015, the Accounting Standardization System for Public Administrations (SNC-AP) was approved through Decree-Law No. 192/2015, which revokes the Official Public Accounting Plan (POCP) and establishes an accounting standard aligned with international accounting standards. The development of this work is based on content analysis focused on Public Accounting Standard 5, NCP 5, which was broken down into the respective chapters of the regulations. In this way, to reach the objective of the study, work was developed on several themes, which are essentially based on the chapters of NCP 5. In this way, the topics covered are: Objectives, Scope and Definitions, Measurement, Recognition and Derecognition; and, in order to better contextualize and exemplify the practical application of the standard, we will find, at the end of this work, some practical situations.

Keywords: NCP 5; SNC-AP; Fixed Assets; IAS

INTRODUCTION

The accounting standardization system defines accounting principles and standards. The public accounting standards, NCP (derived from the SNC-AP) apply to "all services and bodies of central, regional and local administration that do not have the nature, form and designation of a company, to the social security subsector, and to reclassified public entities" (No. 1 of art. 3, MF, 2015b). In the SNC-AP, the NCPs are listed in Annex 2 of the diploma for their approval, and the subject of tangible fixed assets (AFT) is detailed in NCP 5.

In addition to these normative references, it is important to analyze the conceptual structure, namely on the concept of assets. Another important aspect is the disclosure requirements on AFT that can be found in Note 5 of NCP 1 – Structure and Content of Financial Statements.

ANALYSIS OF THE STANDARD

Goal

The objective of NCP 5 is to describe the accounting treatment of tangible fixed assets so that users/users can understand the investments and respective changes (§ 1 of the regulation). Therefore, the standard comprises the main aspects to be taken into account in accounting for AFT, its recognition and its measurement.

Scope

The scope of the standards is of general application unless another standard requires different treatment, in the case of leases, and not applicable to biological assets and mineral rights and mineral reserves - and a specificity - historical heritage - historic buildings and monuments, archaeological sites, areas of conservation and nature reserves and works of art (point 2.1 of NCP 5, MF, 2015b).

It should also be mentioned that the scope of tangible fixed assets of NCP 5 comprises "both public and private domain assets, including military equipment, infrastructure, historical heritage assets and assets of concession contracts after recognition and measurement in accordance with NCP 4" (§3 of NCP 5, MF, 2015b).

Through the study of the scope of the standard, it is verified that NCP 5 encompasses a specific set of assets, which will have to be included in the category of tangible fixed assets in the public sector. In the conceptual framework, the concept of asset is defined as follows:

In the SNC-AP, an asset "is a resource currently controlled by the public entity as a result of a past event" (§88, MF, 2015b) and which "contains itself the ability to provide an inflow of service potential or future economic benefits (...) being able, or not, to assume physical substance" (89, MF, 2015b).

Public sector assets, on the one hand, incorporate "service potential may include assets with recreational, cultural, historical, community and other purposes, which are held by a public entity for the purpose of providing goods or providing services to third parties" (§91, MF, 2015b). On the other hand, "future economic benefits take the form of inflows of cash or cash equivalents, or the reduction of outflows of cash or cash equivalents" (§92 of the SNC, MF, 2015b).

As can be seen from the notion of assets in the public sector, in line with the objectives of these entities, it comprises the goods that provide the provision of public services that are the responsibility of the State, without necessarily having to generate cash inflows.

Definitions

With regard to definitions, the concept of AFT, according to §9 of NCP 5 - MF, 2015b, corresponds to:

- Tangible items/goods with physical substance;

- Held for use in the production or supply of goods or services, for lease/rental to third parties or for administrative purposes;
- AFT expected to be used for more than one reporting period.

The concepts of depreciation, impairment loss, depreciable amount, carrying amount, recoverable amount, residual value and useful life are also of great relevance for understanding the standard under study. Thus, they are presented together in the following table:

Table 1. Definitions of Terms used in NCP-5

Term	Definition
Property, plant and equipment class	Group of assets with the same nature or similar function in the entity's operations, which is shown as a single asset for purposes of disclosure in the financial statements.
Depreciation	It is the systematic allocation of the depreciable amount of an asset over its useful life.
impairment loss	The amount by which the carrying amount of an asset exceeds its recoverable amount.
Recoverable Service Amount	The greater of the fair value of a non-cash-generating asset less costs to sell and its value in use.
depreciable amount	It is the cost of an asset, or other amount that replaces the cost, less its residual value.
carrying amount	It is the amount at which that asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.
recoverable amount	It is the greater of the fair value of a cash-generating asset less costs to sell and its value in use.
Residual value	It is the estimated amount that the entity currently expects to obtain from the disposal of an asset, after deducting the estimated costs of disposal, if such asset were already of the age and condition expected at the end of its useful life.
Lifespan	a) Period of time an asset is expected to be used by an entity; or b) The number of production or similar units that the entity expects to obtain from the asset.

Source:Decree-Law of the SNC-AP

Recognition

Bearing in mind paragraphs 10 to 17 of NCP 5 (MF, 2015b), the recognition of a property, plant and equipment must be in accordance with the concept of assets and property, plant and equipment, and must be measured reliably. Thus, with respect to recognition as an AFT, these must be recognized when it is probable that future economic benefits associated with the asset will flow to the entity, in which the cost or fair value of the asset is reliably measured.

Linked with recognition, acquisitions of spare parts, when recorded in inventories and recognized in profit or loss, after being consumed and if it is expected that their use will last for more than one period, will then be accounted for as tangible fixed assets. The assessment of the costs incurred by the AFT should not only be considered the initial and the result of the acquisition or production, but also the needs of their replacement and/or assistance.

In order for infrastructures to be recognized as AFT, they must show themselves as possessing one or more of the following characteristics: being part of a system or network; be of a specialized nature and have no alternative use; be immovable; and, may be subject to restrictions on disposal. Infrastructure can be road, railway, port, airport, sewage systems, water supply systems, communication networks, among others; military structures, used exclusively in National Defense, and for military purposes are also included, with examples such as shooting ranges, aerodromes, roads and military bridges.

The initial costs of goods acquired for safety or environmental reasons must be registered as AFT, even if they do not directly increase the future economic benefits or the potential of any good, but there is the possibility that they are essential for the realization of the mission of the entity.

In turn, subsequent costs, resulting from constant technical assistance to the asset, as well as the costs of small parts, are not recorded as tangible fixed assets, as they only require maintenance and repairs. However, if it makes a difference in the useful life of the asset, it should affect the underlying tangible asset.

Measurement

In line with the above, the recognition of an element in a financial statement implies that it is assigned a given monetary amount, therefore, the measurement criterion is chosen.

According to the SNC-AP (2015) and as indicated above, the choice of measurement criteria, when applying standard 5, can be of two types: measurement upon recognition and subsequent measurement, depending on the moment of application.

Measurement in Recognition

Upon initial measurement of assets, the standard considers realization at cost (§18 in NCP 5 - MF 2015b) and includes the initial cost plus any directly attributable cost to place the asset in the location and condition of use and initial cost estimate of dismantling and removal and restoration of the place where it is installed. Also referred to in paragraph 28, the cost of a property, plant and equipment is the cash price equivalent.

There are particular situations or exceptions whose standard makes reference, in which the cost may differ from its cash equivalent. An example is the case of assets acquired through a

transaction without consideration, in which the cost is the fair value at the recognition date. In this sense, the measurement is carried out in accordance with paragraph 19 of NCP 5, (a) in the case of real estate, it is measured through its taxable equity value (VPT); (b) for other assets, it is measured at the cost of the asset received, or in the absence, at its market value.

Assets obtained in exchange for one or more non-monetary assets, or a combination of monetary or non-monetary assets are a particular case equally present in norm 5. The cost of an asset acquired in exchange under paragraph 30 shall be measured at fair value. It should also be added, in accordance with paragraph 32, that the fair value of the asset received and the asset given up, if reliably determined “the fair value of the asset given up shall be used to measure the cost of the asset received, the unless this is clearly more evident”.

However, in exchange acquisitions, if the transition does not have commercial substance¹, or if the fair value of the asset received and the asset given up is not possible for its measurement to be carried out reliably, its cost should be measured by the carrying amount of the asset given away.

In summary, the initial measurement or recognition of tangible fixed assets, as a general rule, the measurement criterion applied corresponds to the cost, even so, there is the possibility of using another criterion.

Subsequent Measurement

Paragraphs 33 to 59 of NCP 5 analyze the subsequent measurement after understanding the cost of the asset classified as tangible fixed assets and considering all the elements included. Thus, the cost model translates into the registration of the ATF at its cost minus accumulated depreciation and accumulated impairment losses, applying this policy to an entire class of tangible fixed assets. In public administration, and as an example of asset class, we can highlight roads, electricity distribution infrastructure and military equipment.

However, in certain circumstances, AFT may be subject to revaluation, which must be based on legal regulations for its application. Otherwise entities cannot choose this model.

The revaluation model, at the date of the revaluation of the AFT, is based on the determination of the remaining useful life of the asset. In this case, also at the revaluation date, the accumulated depreciation in the AFT revaluation must be treated in one of the following ways according to paragraph 36 of NCP 5: (a) Eliminated against the gross carrying amount of the asset, the net amount being restated to the revalued amount of the asset. This method should be used in the revaluation of land and buildings; (b) Restated proportionally to the change in the gross carrying amount of the asset, so that the carrying amount of the asset after revaluation equals its revalued amount.

This method should be used when revaluing the remaining tangible fixed assets by applying an index to their depreciated replacement cost.

Measurement after recognition assumes that, in the event that a tangible fixed asset is revalued, the entire class to which it belongs must be revalued. The intent lies in the need to avoid

selective revaluations of assets and to report amounts in the financial statements that include costs and amounts achieved on different dates.

At the time of recognition, it is necessary to take into account some situations such as those presented in the table below.

Table 2. Application of the Revaluation Model

Revaluation by addition (increase)	Revaluation by decrease (decrease)	Asset derecognition (by rebate or sale)
When the carrying amount of an AFT increases due to a revaluation, this increase shall be credited to equity as revaluation surpluses – account 58 – “AFT revaluation surpluses”; On the other hand, this increase should initially be recognized in profit or loss, recording a gain – account 7625 – “Reversal of impairment losses on AFT” up to the limit in which a reduction in the revaluation of the same asset previously recognized in profit or loss reverts.	When the carrying amount of an AFT reduces due to a revaluation, this reduction should be recognized in profit or loss – account 655 – “Impairment losses on AFT”, as a loss for the period; But it is recognized directly in equity – account 58 – up to the limit of any credit balance existing in the revaluation surplus of that same asset.	When part or all of the revaluation surplus included in equity relating to tangible fixed assets can be transferred directly to retained earnings; However, part of the surplus can be transferred when the asset is still being used by the entity. The amount of the surplus to be transferred will be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its initial cost.

Source: Own, based on NCP 5, 2015.

1 ie., “(a) The configuration (risk, timing, and amount) of the cash flows or service potential of the received asset differs from the configuration of the cash flows or service potential of the transferred asset; or (b) The entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and (c) The difference in (a) or (b) is significant with respect to the fair value of the assets exchanged” (§31 of NCP No. 5, SNC-AP, 2015).

Revaluation surpluses to be transferred to retained earnings should not be included in the results for the period.

With regard to the depreciation period and method, at first it should be understood that the depreciable amount of an asset is determined after the reduction of its residual value, and should be allocated on a systematic basis throughout its useful life.

When determining the useful life of an AFT, the following aspects must be taken into account, in accordance with paragraph 51 of NCP 5:

- a) Expected use of the asset, which is evaluated by reference to the expected capacity or physical production of that asset;
- b) Wear expected physical, which depends on operational factors such as the number of shifts during which the asset will be used, the repair and maintenance schedule, and the care and maintenance of the asset while it is idle;
- c) Technical and commercial obsolescence resulting from changes or improvements in production, or from changes in market demand for the products or services produced by the asset;
- d) Limits of a legal or other nature on the use of the asset, such as the expiration dates of related lease agreements.

Thus, the depreciation of an asset begins when it is available for use, ie, when it is in the place and conditions foreseen for its performance, and ends when the asset is derecognised. It is important to mention that the depreciation does not end if the asset becomes idle or withdraws from use and is held for sale, except when the asset is fully depreciated.

Entities, in the course of their activity, take advantage of tangible fixed assets and, consequently, consume their future economic benefits or service potential incorporated in the asset. As mentioned internally, depreciation consists of the systematic allocation of the depreciable amount of an AFT. In this way, different depreciation methods are foreseen to be used, namely:

- The straight-line (or straight-line) method – Succeeds with a linear expense during the asset's useful life, if there is no change in its residual value;
- The declining shares (or declining balance) method – Results from a declining expense during the asset's useful life;
- The unit of production method – It results in an expense based on the expected use or production.

As a rule, the method that best applies to Public Administration is the constant quota or straight line method, thus, the method must be applied periodically, except for the occurrence of a change in the consumption model foreseen in relation to the benefits future economic or service potentials.

As regards upon recognition, depreciation expenses for each period are generally recognized in profit or loss. However, it is worth noting the exceptions in which future economic benefits are absorbed in the production of other assets and, when these situations occur, recognition is part of the cost of that other asset, being included in its carrying amount.

Some assets have a low need for maintenance, so they can be maintained as repairs and maintenance on the asset do not affect the need to depreciate. In turn, when asset management policies worsen the wear and tear of an asset, an adjustment must be made in accordance with reality and a review of its useful life must be carried out.

Assets such as land and buildings, must be accounted for separately, even when they are acquired together. In the absence of the definition of the value corresponding to the two parts,

75% of the value for the building and 25% for the land are accounted for, as the latter has an unlimited useful life and is not subject to depreciation, with rare exceptions. Buildings, in turn, subject to great and continuous wear, are depreciable and have a limited useful life.

In order to determine whether or not a property, plant and equipment is impaired, the entity must apply NCP 9 – Impairment of Assets, which explains when and how an entity should review the carrying amount of its assets and when it should recognize or derecognise an impairment loss.

Lost tangible fixed assets, impairment losses, and the respective compensations or indemnities paid to third parties, as well as subsequent purchases or constructions of replacement assets, correspond to different economic events and their accounting must be carried out as follows: impairments of AFT assets must be taken into account and recognized supported in NCP 9; AFT assets derecognized by slaughter or sale must be established as indicated in the standard under study.

According with the provisions of paragraphs 58 and 59 of NCP 5, compensation by third parties relating to tangible fixed assets that have suffered impairment, or have been lost or transferred, must be included in the results when such compensation becomes receivable.

Impairments or losses of tangible fixed assets, and respective payments of indemnities or compensations by third parties, and any purchase or construction of replacement assets, constitute separate economic events and shall be accounted for as follows: (a) The impairment of property, plant and equipment shall be recognized in accordance with NCP 9; (b) The derecognition of property, plant and equipment disposed of or disposed of shall be determined in accordance with this Standard; (c) Compensation by third parties for property, plant and equipment that are impaired, lost or given up shall be included in the determination of profit or loss when it becomes receivable; and (d) The cost of property, plant and equipment restored, purchased or constructed as a replacement shall be determined in accordance with this Standard.

Misrecognition

The derecognition of an AFT asset must be carried out:

- at the time of disposal (including disposal through a transaction without consideration); or
- when no future economic benefits or service potential are expected from use or disposal.

Gains or losses arising from the derecognition of a property, plant and equipment asset shall be established by the difference between the net proceeds of the disposal, if any, and the carrying amount.

Upon derecognition of the asset, it must be recognized in the results, except in the case of a sale followed by a lease, in this case, you must act as established in NCP 6.

Finally, when the cost of replacing a part of the asset is recognized in the carrying amount of the AFT asset, it is necessary to derecognise the carrying amount of the replaced part, without taking into account the fact that it was depreciated separately. If the carrying amount of the replaced part cannot be determined, the replacement cost is used as an indicator at the date of acquisition or construction.

PRACTICAL CASE

In order to consolidate the concepts, definitions, models and themes addressed during this work, more specifically, with respect to standard 5 of the SNC-AP, some practical applications in NCP 5 are presented below.

Situation 1

The Lourinhã City Council purchased basic equipment for the IT department for 100,000 euros, with a 10% discount. The machine will be depreciated by the straight-line method, for 8 years, with a residual value of nil.

The costs related to acquisition and assembly were: the cost of transporting the equipment from the supplier's warehouse to the City Council's premises, in the amount of 1,350.00 euros; the cost of installation and assembly reached €1,875; the training of employees in the IT department who will have direct contact with the new equipment amounted to 2,500.00 euros; the campaign to announce the new services provided by the equipment cost 800.00 euros. The amounts mentioned include VAT at the standard rate, which is non-deductible VAT.

In the case presented by the Câmara da Lourinhã, to calculate the cost of the new basic equipment for the IT department, the following calculations must be carried out.

Equipment acquisition cost	Amount
Purchase price with commercial discount	90 000.00
Transportation expenses	1 350.00
Installation and Assembly	1 875.00
Total	93 225.00

The table above concerns the acquisition cost of an ATF, as these are likely to bring future economic benefits to the entity or service potential associated with the asset and the cost or fair value of the asset can be reliably measured, as set out in paragraph 10 of NCP 5.

The costs directly attributed to the acquisition of the asset will be all those that allow the asset to reach the entity's location and present itself in ideal conditions for its proper functioning and use.

To proceed with the accounting of the acquisition and depreciation at the end of the first year of the asset, it is necessary to make the following accounting record.

Description	debt	Credit
4331 - Computer and telecommunications equipment	93 225.00	
2711 - Investment providers general accounts		93 225.00
For the acquisition of computer equipment		
632208 - Training	2 500.00	
6222 - Advertising, communication and image	800.00	
121 - Demand deposit at the Treasury		3 300.00
For expenses not included in the acquisition cost		
6423 - Depreciation costs of tangible fixed assets - basic equipment	11 653.13	
4383 - Accumulated depreciation of tangible fixed assets - basic equipment		11 653.13
For the depreciation of the asset in the first year		

This table shows the costs that are not included in tangible fixed assets, as well as the determination of depreciation using the straight-line method, taking into account the useful life of the asset (8 years).

Situation 2

Lourinhã City Council built a wastewater treatment plant next to Peralta beach, with the obligation to dismantle the plant after 13 years of use. The construction cost was €1,287,000.00, with an estimated dismantling cost of €90,000.00. No VAT effect is considered. Considering a discount rate of 5%, calculating the cost of the factory, keeping in mind the cost of dismantling, the current value is:

90 000

$(1 + 0.05)^{13} = 47,728.92 \text{ €}$ —————

The cost of the wastewater treatment plant is:

$1\,287\,000 + 47\,728.92 = 1\,334\,728.92 \text{ €}$

For accounting registration, the following entries were considered:

Description	debt	Credit
432 - Buildings and other constructions	1 334 728.92	
2711 - Investment providers general accounts		1 287 000.00
298 - Other provisions		47 728.92
Recognition of the provision for decommissioning costs.		

Initially, the acquisition and construction of a wastewater treatment plant was recorded, including the initial estimate of the dismantling costs which the entity is obliged to bear when the asset is acquired or as a result of its use.

From N+1 to N+13, the amount of the provision will have to be updated so that at the end of N+13 the value will be 90,000.00. So in the first year the update will be:

$$47\,728.92 \times 0.05 = 2,386.45 \text{ €}$$

Description	debt	Credit
6918 - Other interest	2,386.45	
298 - Other provisions		2,386.45
By updating the provision amount		

In a second year, the launch is repeated by the value of:

$$(47\,728.92 + 2\,386.45) \times 0.05 = 2,505.77 \text{ €}$$

Therefore, depreciation, considering a useful life of 13 years, is carried out at the cost of €1,334,728.92, meaning that the depreciation charges take into account all costs.

CONCLUSION

The application of the SNC-AP from 2015, as it could be seen, presents some peculiarities exclusive to the public sphere, highlighting the fact that an element can be recognized as an asset, even if it does not produce income and as long as it has potential to service.

The detailed study throughout this work allowed us to understand the entire process of recognition, measurement and derecognition of tangible fixed assets, ranging from the recognition of an asset to the assumptions required for recognition.

In general, the standard comprises as its main objective the accounting recognition of tangible fixed assets, based on standardization, and allowing entities regulated by this standard to present the same procedures, giving rise to financial information that can be compared, so that it becomes interesting and better understood by all interested parties or users of this information.

Concluding the study of standard 5 of the SNC-AP, it is considered that all the objectives were fulfilled, from the analysis of the most relevant paragraphs according to the standard, to the application of the standard when carrying out the practical cases, which allowed a better understanding given the context within public entities.

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