

ACT ACCOUNTING POLICY



AAPP 101 - ACT Accounting Policy Paper on Capital Works

**FOR REPORTING PERIODS ENDING ON OR AFTER
30 JUNE 2006**

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1 Introduction

1.1 Application

1.1.1 *This Policy*

This ACT Accounting Policy: *Capital Works* provides general guidance to ACT Government agencies to assist them in determining when and what costs associated with capital works projects should be capitalised. This Policy is to be read in conjunction with the following:

- AASB 116 *Property, Plant and Equipment*.

Note however, that this policy does not cover accounting issues for completed capital works projects. Accounting policies related to completed capital works projects are contained in the:

- ACT Accounting Policy Paper on Property, Plant and Equipment;
- ACT Accounting Policy Paper on Heritage and Community Assets; and
- ACT Accounting Policy Paper on Impairment of Assets.

1.1.2 *Relationship to International Financial Reporting Standards*

ACT Accounting Policies are to be read in conjunction with the applicable Australian Accounting Standards. Australian Accounting Standards incorporate International Financial Reporting Standards issued by the International Accounting Standards Board, with the addition of paragraphs on the applicability of each standard in the Australian environment. This policy assists agencies to apply the requirements within Australian Accounting Standards to capitalise costs associated with capital works projects.

There is, however, no intention that the ACT Accounting Policies will replicate the Accounting Standards. Consequently, agencies should ensure that they have a thorough understanding of the content of the standards before reading and applying relevant ACT Accounting policies.

1.1.3 *Application Date*

This ACT Accounting Policy Paper applies to reporting periods ending on or after 30 June 2006.

1.1.4 *Agencies covered by this Policy*

This policy applies to directorates and Territory authorities.

1.1.5 Contact

If you have any questions regarding the content or application of this ACT Accounting Policy, please do not hesitate to contact the ACT Accounting Branch policy section to provide further clarification. Contact details are listed on the website: www.treasury.act.gov.au/accounting/html/contacts.htm

2 Capital Works

2.1 Asset Definition

In determining whether to capitalise or expense costs associated with a capital works project, it must first be determined whether or not the capital works project meets the asset definition. An asset is defined as 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 (*AASB Framework for the Preparation and Presentation of Financial Statements* paragraph 49).

Future economic benefits are not limited to situations involving future cash inflows, as they are also synonymous with the notion of service potential. Future economic benefits refer to the capacity to provide goods and services in accordance with the entity's objectives, including the provision of goods or services to the public e.g. provision of education facilities to ACT residents.

2.2 Asset Recognition

Costs that meet the definition of an asset must also meet the recognition criteria before an asset can be recorded in the financial statements. The recognition criteria states that assets should be included in the financial statements when it is probable that the entity will receive future economic benefits and that the asset can be measured reliably (*AASB Framework for the Preparation and Presentation of Financial Statements* paragraph 89).

The concept of 'probable', included in the recognition criteria above, refers to an event being more likely than less likely of occurring, that is, there is a greater than 50% chance that the future economic benefits will occur.

The concept of reliable measurement refers to whether the nature of the asset is inherently difficult to measure. It is the nature of the asset that determines whether it can be measured reliably rather than an entity not having the systems in place to measure an asset reliably. Except in rare cases, the nature of the costs incurred in capital works projects will be able to be measured reliably. Agencies should ensure that there are appropriate accounting systems in place before the commencement of a project so that costs are recorded correctly.

2.3 What costs should be capitalised

In general, an asset is measured at the cost of acquiring or constructing the asset. The cost of an item includes not only its purchase price or direct construction costs, but also includes any other costs that are 'directly attributable' in bringing the asset to a location and condition ready for use, as well as the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located (where there is a present obligation to do so) (AASB 116.16).

'Directly attributable' costs are costs that, if not incurred, would result in the asset not being able to be used and therefore not being able to provide future economic benefits to the entity. Examples of 'directly attributable' costs are (AASB 116.17):

- cost of site preparation;
- initial delivery and handling costs of materials for the capital works project;
- installation and assembly costs;
- costs of testing that the asset is functioning properly; and
- professional fees.

Certain costs may occur in connection with the construction or development of an asset that are not 'directly attributable' to the asset. These incidental costs are recognised as expenses when incurred. An example of a related cost that cannot be capitalised, is the cost of relocating staff into the new building at the completion of the project.

Once costs have been expensed they cannot subsequently be capitalised in future years (except where an error has occurred in the initial treatment). Costs expensed early in a capital works project, because at that time it was not probable that the asset would eventuate, cannot subsequently be capitalised if the project proceeds and the asset is built.

3 Project Classification and Accounting Treatment

3.1 Capital Works Program

The Territory's Capital Works Program is detailed in 'Capital Initiative Proposals – Process and Guidelines'. Copies can be obtained from your Treasury Directorate Agency Financial Analyst. The program consists of two categories:

3.1.1 Capital Upgrades

Capital upgrades are activities or minor works intended to extend the effective useful life of an existing asset or improve an asset's service potential. An example of a capital upgrade project is the complete upgrade of a science laboratory (so that the laboratory is better and more functional than previously); and

3.1.2 New Construction

Projects that are categorised as capital upgrades or new construction are potentially capital in nature as the intention is to provide future economic benefits. The process

to obtain capital works funding for capital upgrades is different to the process of obtaining new construction funding. Therefore this accounting policy separately addresses the accounting treatment of both funding processes in the below sections as follows:

- ‘Accounting Treatment of Capital Upgrades’; and
- ‘Accounting Treatment of New Construction’

Note that self-funded capital works should follow the same accounting treatment as mentioned below for projects that are funded through the capital works process.

3.1.3 Repairs and Maintenance

Repairs and maintenance projects merely maintain assets in their original state. Repairs and maintenance is necessary to allow the continued use of existing assets. An example of a repairs and maintenance project is the replacement of old gas taps in a science laboratory (so that the laboratory can continue to be used in its current capacity). A repairs and maintenance project is not capital in nature as it does not provide future economic benefits. Therefore, all repairs and maintenance costs are to be expensed.

3.2 Accounting Treatment of Capital Upgrades

The following table provides a step-by-step outline of the phases in a typical capital upgrades project. A detailed discussion of accounting issues relevant to capital works projects is covered under Section 3.3 *Accounting Treatment of New Construction*.

Most of the phases of a capital upgrade project are the same as the phases of a new construction project. The only difference is that the first two phases for new construction projects is replaced by one phase entitled ‘Phase 1 – Application for Capital Upgrade Funding’. This first Phase is described below. As all other Phases are basically identical to new capital works projects, refer to Section 3.3 *Accounting Treatment of New Construction* for a description of these phases.

The descriptions in Section 3.3.1 *Common Costs incurred throughout the Project* and Section 3.3.2 *Project Team Staff Costs* are also applicable to capital upgrades.

3.2.1 Phase 1 – Application for Capital Upgrade Funding

The first step of a capital upgrade project is to develop a ‘Strategic Asset Management Plan’. This plan is then used to develop a five-year funding plan. This funding plan is then reviewed annually against agency performance and the Strategic Asset Management Plan.

The ‘Strategic Asset Management Plan’ is generally completed in-house and funding will be from the agency’s own resources (that is GPO funded). Also the staffing costs incurred in developing these plans will be incurred regardless of whether the plans are developed. As a result, these staffing costs should be expensed.

Table 1: Summary of Accounting Treatment of Capital Upgrades

| PHASE | STEPS | COST ITEMS | ACCOUNTING TREATMENT |
|---|--|---|---|
| Phase 1 – Application for Capital Upgrade Funding | Preparation of Strategic Asset Management Plan | Staff costs: - Project team - Everyday operational | Expense Expense |
| Phase 2 - Forward Design | Engage Project Director/Manager | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs Travel costs | Capitalise Expense Capitalise Capitalise |
| | Design Agent produces the required design documents | Architectural / Design Consultant costs Quantity Surveyor costs Specialist Consultant costs Travel costs | Capitalise Capitalise Capitalise Capitalise |
| | Design Acceptance | Staff costs: - Project team - Everyday operational | Capitalise Expense |
| Phase 3 – Construction | Pre-Construction Relocation (Staff are moved to temporary accommodation ([where applicable]) | Staff costs: - Project team - Everyday operational Removalist costs Rental costs Minor fit out costs | Capitalise Expense Capitalise Expense Expense |
| | Project Director/Manager goes out to tender for construction | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs - Tender costs Insurance Costs Travel Costs | Capitalise Expense Capitalise Capitalise Capitalise Capitalise |
| | Project Director/Manager engages Builder and other construction contractors | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs - Construction costs | Capitalise Expense Capitalise Capitalise |
| | Defect period commences after formal handover. Staff, through Project Director (or Project Manager), ensure defects list is completed and defects fixed. | Staff Costs: - Project team - Everyday operational | Capitalise Expense |

| PHASE | STEPS | COST ITEMS | ACCOUNTING TREATMENT |
|--|--|--|---|
| Phase 4 - Fit-Out | Tender for Project Manager | Staff costs: - Project team - Everyday operational Tender Costs | Capitalise Expense Capitalise |
| | Project manager selected for fit-out | Staff costs: - Project team - Everyday operational Project Management costs Consultant costs | Capitalise Expense Capitalise Capitalise |
| | Purchase of fit-out items | Asset Purchase costs | Capitalise |
| | Installation of assets | Fit-out costs | Capitalise |
| Phase 5 – Post-Construction Relocation | Moving into completed building (where applicable) | Staff costs: - Project team - Everyday operational Removalist costs | Expense Expense Expense |
| Phase 6 - Running Costs | There are costs that agencies should take note of after the project completion stage for planning their future funding requirements. | Depreciation Ongoing repair & maintenance Insurance cost | Expense Expense Expense |
| Whole of Project Costs | There are a number of costs that may be incurred during any phase of a capital works project. | Training costs - all phases Meeting costs - all phases Steering Committee costs- all phases Borrowing costs- all phases | Expense Expense Expense Expense |

3.3 Accounting Treatment of New Construction

The following is a step-by-step outline of the phases in a typical new construction project. Based on the accounting principles, the appropriate accounting treatment for both common costs incurred throughout the project (regardless of which phase they occur in) and the costs incurred in each phase have been determined.

3.3.1 Common costs incurred throughout the project

There are a number of costs that may be incurred during any phase of a capital works project. The accounting treatment for these costs is consistent throughout the project, regardless of which stage they occur in:

a) Everyday operational costs

These are costs incurred as part of the everyday operations of an agency, and would be incurred regardless of whether the capital works project proceeds. Note that where permanent staff are seconded to a capital works project team their costs should be accounted for in accordance with the below section titled

‘Project Team Staff Costs’. All costs relating to the delivery of outputs are to be recorded in the Operating Statement as expenditure for the delivery of outputs.

Examples of such costs are:

- steering committee costs – including staffing costs as these costs will be incurred regardless of whether steering committee meetings occur;
- on-going maintenance / capital acquisitions staff costs - including staff working on repair and maintenance projects, and staff responsible for purchasing assets as part of their normal work duties. These costs relate to the delivery of outputs and are funded by *base*-GPO (i.e. GPO funding exists for these positions irrespective of capital works projects); and
- generic training costs – including generic training for capital works staff e.g. business writing, financial management.

b) Capital Works Specific Training costs

Agencies might incur costs for capital works training such as project management. These costs are expensed as they do not increase the future economic benefit of the capital works project.

c) Borrowing costs

Although AASB 123 *Borrowing Costs* allows borrowing costs to be expensed or capitalised, ACT accounting policy requires borrowing costs to be expensed. This is in order to achieve the required harmonisation with Government Financial Statements (GFS) reporting requirements.

3.3.2 Project Team Staff Costs

Often, a project team is established to manage a major capital works project(s). Project team staff costs are distinct from on-going maintenance / capital acquisitions staff costs that are regarded as everyday operational costs (see above). Project team staff:

- a) spend the majority of their time working on a specific capital works project or are dedicated to managing a number of capital works projects; and
- b) are not *base*-GPO funded (i.e. position is funded from the capital works funding received as either GPO or capital injection).

Where dedicated project team staff are working on multiple capital works projects, a reasonable basis for allocating project team staff costs must be established.

Project team staff costs include the following costs in relation to agency staff seconded to the project team and any contractors employed for the team:

- a) salaries and wages;
- b) superannuation costs;
- c) overtime costs; and

d) allowances e.g. meal allowances.

A Project team will often be established for the majority of the life of the project. There is no consistent treatment for project team staff costs throughout the project. The appropriate accounting treatment for project team staff costs i.e. whether they are expensed or capitalised, is dependent on the phase in which the costs are incurred.

3.3.3 Phase 1: Concept Development

The first step of a major capital works project is to develop a 'Project Concept Brief'. A 'Project Concept Brief' involves preparing a brief description of the proposed project. This may include the perceived shortfall in service delivery capabilities, within the background, context and rationale of agency objectives, whole-of-government outcomes and community needs. The 'Project Concept Brief' will generally be performed in-house, and will not be a time consuming process. Funding for this stage will be from the agency's own resources.

Since the Concept Development Phase only involves the development of a 'Project Concept Brief', which contains a very basic outline of the project, there is no certainty the project will progress to the next stage, let alone the construction of the asset itself. As there is no certainty that the construction will occur, it is not probable that future economic benefits will flow to agencies from the costs incurred in phase 1. As a result, all costs in this phase should be expensed when incurred.

3.3.4 Phase 2: Feasibility Study (Financial and Economic Business Case)

The first step in the Feasibility Study Phase is the preparation of a proposal requesting funding for the feasibility study (where agencies require funding assistance).

An agency then undertakes a feasibility study of the proposed capital works project. Based on the findings of the study, the agency then prepares a Forward Design Proposal and a Cost Benefit Analysis to request funding for the forward design of the proposed project (if funding is required). Funding for this stage may be from the agency's own resources, or from capital works funding. The Forward Design Proposal and a Cost Benefit Analysis are generally performed in-house, however consultants can be engaged to assist in this process.

Although the project has progressed further than phase 1, there is still insufficient certainty that the project will be approved in the capital works budget process. Thus, it is not probable as yet, that future economic benefits are likely to flow from the costs incurred in Phase 2. Therefore, all costs incurred at this stage should be expensed.

3.3.5 Phase 3: Forward Design

In the forward design phase, a project director/manager, responsible for managing the capital works project on behalf of the agency, coordinates the completion of the design specifics for the project. Although agencies usually approach Procurement

Solutions to be the project director of the capital works process, agencies are also able to engage an external project manager (external to the ACT Government).

The project director/manager appoints a design agent who produces the following:

- Conceptual Design Plans;
- Preliminary Sketch Plan (PSP);
- Final Sketch Plan (FSP); and
- Tender drawings/documents.

The above plans are then used by the agency to complete a Business Case Proposal requesting final construction funding approval. The Business Case can be performed in-house or consultants can be engaged to assist in this process.

Even though the costs incurred in the Forward Design Phase arise before the final construction approval, it is considered probable that projects reaching this stage of the capital works process will go ahead and therefore the project will provide future economic benefits to the agency. Also costs incurred during the forward design phase are 'directly attributable' in enabling the construction of the capital works project to proceed. Therefore all costs incurred in Phase 3 should be capitalised, with the exception of everyday operational costs which are expensed (see Section 3.3.1 *Common Costs Incurred throughout the Project* above). Forward design costs are capitalised into a capital works in progress account and while in this account are not depreciated. Depreciation only commences when the entire capital works project is completed and transferred out of the capital works in progress account to the appropriate property, plant and equipment asset class (also see Section 3.3.9 *Phase 7: Running Costs*). This is because the Forward Design costs are not considered to be a separate asset from the physical asset being constructed, and as such should not be depreciated until such time as the asset is recognised as complete.

3.3.6 Phase 4: Construction

Pre-construction relocation is sometimes necessary when the occupants of a building are required to be relocated in order for the existing building to be demolished and rebuilt. The pre-construction relocation step in this phase will not occur in all projects.

As this step occurs immediately prior to the commencement of building, it is probable that the capital works project will be completed and will provide future economic benefits to the agency. Removalist costs are incurred as part of the site preparation. Site preparation costs are classified as 'directly attributable' costs in AASB 116.17 (b) as without these costs the capital works project could not proceed. That is, unless staff are moved out of the existing building, the new building cannot be completed. Therefore removalist costs should be capitalised.

The displaced occupants of the building will require temporary accommodation, in the interim, to continue their usual operations. Minor fit-out costs may be incurred at the temporary premises to enable the continuation of day-to-day operations. As these costs are incurred for the purposes of the ordinary operations of the agency and are

not 'directly attributable' to the construction, and as such they should be expensed as part of the agency's normal operating costs.

The construction step of this phase of the project involves the project director/manager undertaking a tender process and awarding a contract for the construction of the project. Tendering costs, including consultant costs, travel costs and advertising costs, are capitalised as they will generate future economic benefits.

Once the contract is finalised, construction of the project commences. Construction costs are capitalised as it is probable that the work will be completed and the new asset will provide future economic benefits to the agency.

3.3.7 Phase 5: Fit-Out

Phase 5 will occur in many capital works projects. This phase involves the purchase and installation of items, in order for the capital works project to be ready for use. This phase will generally be applicable to the construction of buildings.

Project management of the fit-out can either be performed by the agency, or the agency can undertake a tender process and contract out the project management to an external provider. Project management costs are capitalised as they will generate future economic benefits and are 'directly attributable' to the project.

The purchase price and installation of the fit-out items (eg office partitioning) are capitalised, subject to the agency's individual asset capitalisation threshold. This is because the fit-out items provide future economic benefit and the installation costs are 'directly attributable' in bringing the fit-out items to the condition and location ready for use. These items are generally capitalised as a separate plant and equipment asset rather than capitalised into the building asset which has been constructed, however this will depend on the nature of the fit-out items.

3.3.8 Phase 6: Relocation

This Phase will not occur in all projects. Phase 6 involves relocating staff from their existing location to the newly constructed building. These costs are incurred once the new building is completed and ready for use by the agency.

These costs are incurred to ensure that the normal recurring operations of the entity can continue. The costs do not increase the future economic benefits of the capital works project and are not 'directly attributable' to the project.

These removalist costs are accounted for differently to Phase 4 removalist costs because Phase 4 removalist costs are part of the site preparation and are therefore classified as 'directly attributable' costs as the existing building must be vacated to enable building or demolition to commence. Conversely, in this Phase the building is already completed so that removalist costs are not 'directly attributable' in the completion of the building. As a result Phase 6 relocation costs are expensed.

3.3.9 Phase 7: Running Costs

Phase 7 occurs after the capital works project is completed. Running costs are the on-going costs associated with normal operations, such as repairs and maintenance, insurance costs, and depreciation. Running costs should be expensed, as they are incurred in the course of ordinary activities of the agency rather than as part of the capital works project.

Depreciation of the asset commences when capital works projects are completed and ready for use (see AASB 116.55).

Table 2: Summary of Accounting Treatment of New Construction

| PHASE | STEPS | COST ITEMS | ACCOUNTING TREATMENT |
|--|---|--|--|
| Phase 1 – Concept Development | Project Concept Brief | Staff costs: - Project team - Everyday operational | Expense Expense |
| Phase 2 – Feasibility Study (Financial and Economic Business Case) | Proposal requesting Capital Works funding for a feasibility study | Staff costs: - Project team - Everyday operational Consultant costs Travel costs | Expense Expense Expense Expense |
| | Feasibility Study (Needs Assessment) | Staff costs: - Project team - Everyday operational Consultant costs Travel costs | Expense Expense Expense Expense |
| | Forward Design Proposal and Cost Benefit Analysis (both prepared using Feasibility Study results) | Staff costs: - Project team - Everyday operational Consultant costs Travel costs | Expense Expense Expense Expense |
| Phase 3 - Forward Design | Engage Project Director/Manager | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs Travel costs | Capitalise Expense Capitalise Capitalise |
| | Design Agent produces the required design documents | Architectural / Design Consultant costs Quantity Surveyor costs Specialist Consultant costs Travel costs | Capitalise Capitalise Capitalise Capitalise |
| | Design Acceptance | Staff costs: - Project team - Everyday operational | Capitalise Expense |

| PHASE | STEPS | COST ITEMS | ACCOUNTING TREATMENT |
|--|--|---|---|
| | Business Case Proposal for Construction Funding (using results from Feasibility Study and Forward Design) | Staff costs: - Project team - Everyday operational | Capitalise Expense |
| Phase 4 – Construction | Pre-Construction Relocation (Staff are moved to temporary accommodation ([where applicable]) | Staff costs: - Project team - Everyday operational Removalist costs Rental costs Minor fit out costs | Capitalise Expense Capitalise Expense Expense |
| | Project Director/Manager goes out to tender for construction | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs - Tender costs Insurance Costs Travel Costs | Capitalise Expense Capitalise Capitalise Capitalise Capitalise |
| | Project Director/Manager engages Builder and other construction contractors | Staff costs: - Project team - Everyday operational Procurement costs: - Project Management costs - Construction costs | Capitalise Expense Capitalise Capitalise |
| | Defect period commences after formal handover. Staff, through Project Director (or Project Manager), ensure defects list is completed and defects fixed. | Staff Costs: - Project team - Everyday operational | Capitalise Expense |
| Phase 5 - Fit-Out | Tender for Project Manager | Staff costs: - Project team - Everyday operational Tender Costs | Capitalise Expense Capitalise |
| | Project manager selected for fit-out | Staff costs: - Project team - Everyday operational Project Management costs Consultant costs | Capitalise Expense Capitalise Capitalise |
| | Purchase of fit-out items | Asset Purchase costs | Capitalise |
| | Installation of assets | Fit-out costs | Capitalise |
| Phase 6 – Post-Construction Relocation | Moving into completed building (where applicable) | Staff costs: - Project team - Everyday operational Removalist costs | Expense Expense Expense |
| Phase 7 - Running Costs | There are costs that agencies should take note of after the project completion stage for planning their future | Depreciation Ongoing repair & maintenance Insurance cost | Expense Expense Expense |

| PHASE | STEPS | COST ITEMS | ACCOUNTING TREATMENT |
|------------------------|---|--|--|
| | funding requirements. | | |
| Whole of Project Costs | There are a number of costs that may be incurred during any phase of a capital works project. | Training costs - all phases Meeting costs - all phases Steering Committee costs- all phases Borrowing costs- all phases | Expense Expense Expense Expense |

3.4 Implications for Budgets and Financial Reporting

The accounting treatment of costs incurred in relation to capital works projects should be based on the accounting principles as outlined in this accounting policy, in accordance with the relevant accounting standards. How an agency is funded for their capital works project should not determine the accounting treatment applied to project costs i.e. all project costs should not be capitalised purely because the funding for the project was received as a capital injection.

Agencies should consider the appropriate accounting treatment for project costs when applying for funding, so that the funding requested reflects as much as possible the subsequent accounting for costs as either expenses or assets. For example, as costs for a Feasibility Study should be expensed, agencies should apply for GPO funding for these costs. Correct matching of capital injections with capitalised costs and GPO funding with expenditure ensures there is minimal impact on an agency's financial performance in relation to its budgeted operating result.