



ACCOUNTING STANDARDS BOARD

DIRECTIVE 7

THE APPLICATION OF DEEMED COST

Acknowledgment

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DIRECTIVE 7: THE APPLICATION OF DEEMED COST

This Directive was originally issued by the Accounting Standards Board (the Board) in December 2009. Since then, it has been amended by:

- Consequential amendments when the Standards of GRAP on *Transfer of Functions Between Entities Under Common Control* (GRAP 105) and *Mergers* (GRAP 107) were amended to clarify some of the principles.
- Consequential amendments arising from the Standard of GRAP on *Living and Non-living Resources* (GRAP 110) issued in December 2017.

Introduction

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (including national, provincial and government components);
- (b) public entities;
- (c) trading entities (as defined in the PFMA);
- (d) constitutional institutions;
- (e) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (f) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of International Financial Reporting Standards (IFRS[®] Standards) issued by the International Accounting Standards Board[®] for:

- (a) public entities that meet the criteria outlined in the Directive on *The Selection of an Appropriate Reporting Framework by Public Entities*; and
- (b) entities under the ownership control of any of these entities.

Section 89(1)(b) of the PFMA, requires the Board to prepare and publish directives and guidelines concerning the Standards of GRAP as set in paragraph 89(1)(a) of the PFMA. The *Preface to the Standards of GRAP* determines that directives will be used to set transitional provisions and transitional arrangements for the entities required to comply with Standards of GRAP. Directives issued by the Board in terms of section 89(1)(b) of the PFMA therefore have the same authority as the Standards of GRAP.

Directives should be read in conjunction with the relevant Standards of GRAP or Interpretations of the Standards of GRAP, as well as the *Preface to the Directives*.

Objective

- .01 The purpose of this Directive is to outline when an entity applies a deemed cost if the acquisition cost of assets cannot be determined on the adoption of certain Standards of GRAP, or when a transfer of functions between entities under common control or a merger occurs. This Directive outlines how that deemed cost should be determined.

Scope

- .02 This Directive shall be applied by entities that apply Standards of GRAP. This Directive can only be used:
- (a) to determine the cost of assets that were acquired prior to the measurement date outlined in paragraph .05, and only if information about the historical cost of those assets is not available; and
 - (b) to determine the cost of assets that were acquired in a transfer of functions between entities under common control or in a merger where:
 - (i) the transferor or combining entity did not apply Standards of GRAP on the transfer date or the merger date; and
 - (ii) when information about the historical cost of those assets are not available.
- .03 This Directive cannot be applied by analogy to any other circumstance, transaction or event other than those outlined in paragraph .02.
- .04 This Directive does not address:
- (a) the deemed cost of inventories and similar current assets as it is not likely that the cost or fair value of these assets cannot be determined. The short-term nature of inventory and similar current assets requires that they are purchased frequently and written down when appropriate; and
 - (b) the deemed cost of biological assets that form part of an agricultural activity. These assets are initially measured at fair value in accordance with the Standard of GRAP on *Agriculture*.

Definitions

- .05 The following terms are used in this Directive with the meanings specified:
- Acquisition cost: When an entity initially recognises assets such as items of property, plant and equipment, investment properties, intangible assets and heritage assets using the Standards of GRAP, it measures those assets using either cost (if the asset is acquired in an exchange transaction) or at fair value (if the asset is acquired in a non-exchange transaction). This cost or fair

value on initial acquisition of an asset or when the cost of an asset needs to be determined on the transfer date or the merger date is the acquisition cost.

- Deemed cost: Deemed cost is a surrogate value for the cost or fair value of an asset at its initial acquisition, and is determined by reference to the fair value of the asset at the date of adopting the Standards of GRAP or on the transfer date or the merger date (measurement date).
- Initial acquisition (for purposes of this Directive): Assets acquired before the date of adopting Standards of GRAP or assets acquired in a transfer of functions between entities under common control or in a merger.
- Measurement date (for purposes of this Directive): Measurement date is either (a) the date that an entity adopts the Standards of GRAP and is the beginning of the earliest period for which an entity presents full comparative information, in its first financial statements prepared using Standards of GRAP; or (b) the transfer date or the merger date.

The application of deemed cost

Use of deemed cost for property, plant and equipment, investment property, intangible assets, heritage assets and living resources

- .06 When an entity initially recognises or acquires an asset using the Standards of GRAP, it measures such assets using either cost or fair value (acquisition cost). Where the acquisition cost of an asset is not available on the adoption of the Standards of GRAP or on the transfer date or the merger date (initial acquisition), acquisition cost is measured using a surrogate value (deemed cost) at the date an entity adopts the Standards of GRAP or on the transfer date or the merger date (measurement date). Deemed cost is determined as the fair value of an asset at the measurement date.
- .07 An entity may have determined a deemed cost for an asset under another basis of accounting where information about the acquisition cost of the asset was unavailable. A deemed cost determined for an asset under another basis of accounting is acceptable for purposes of this Directive if it represents the fair value of the asset as described in paragraph A3. or, its cost or depreciated historical cost.
- .08 In the absence of information about the acquisition cost of an asset, deemed cost is used for the following assets:
- (a) Property, plant and equipment.
 - (b) Investment property, only if an entity elects to use the cost model in the Standard of GRAP on *Investment Property* (GRAP 16). If an entity adopts the fair value model for investment property, it measures investment property at fair value at the date the entity adopts the Standards of GRAP.

- (c) Intangible assets that meet:
 - (i) the recognition criteria in the Standard of GRAP on *Intangible Assets* (GRAP 31); and
 - (ii) the criteria in GRAP 31 for revaluation (including the existence of an active market).
- (d) Heritage assets (see the Standard of GRAP on *Heritage Assets* (GRAP 103)).
- (e) Living resources (see the Standard of GRAP on *Living and Non-living Resources* (GRAP 110))

An entity shall not use deemed cost for other assets or for liabilities.

- .09 With the exception of .08(b) above, an entity applies this Directive irrespective of whether it applies the cost or revaluation model in accordance with the Standard of GRAP on *Property, Plant and Equipment* (GRAP 17), GRAP 31, GRAP 103, or GRAP 110.
- .10 If fair value at the measurement date cannot be determined for an item of property, plant and equipment, investment property or a heritage asset, an entity may estimate such fair value using:
 - (a) depreciated replacement cost at the measurement date for an item of property, plant and equipment;
 - (b) depreciated replacement cost at the measurement date for an investment property, but only if the investment property is of such a specialised nature that there is no market-based evidence of fair value; and
 - (c) replacement cost at the measurement date for heritage assets.
- .11 If an entity uses deemed cost for an item of property, plant and equipment, an investment property, an intangible asset, a heritage asset, or a living resource, following the initial adoption of a Standard of GRAP, a transfer of functions or a merger, its first statement of financial position prepared using Standards of GRAP, or the financial statements following a transfer of functions or a merger shall disclose:
 - (a) for each line item:
 - (i) the aggregate of those items valued using deemed cost;
 - (ii) the aggregate adjustment to the carrying amounts previously reported; and
 - (b) a description of whether deemed cost was determined:
 - (i) using fair value or depreciated replacement cost for items of property, plant and equipment and investment properties; and

- (ii) using fair value or replacement cost for heritage assets.

Use of deemed cost for investments in controlled entities, jointly controlled entities and associates

- .12 When an entity prepares separate financial statements, the Standard of GRAP on *Consolidated and Separate Financial Statements* (GRAP 6) requires it to account for its investments in controlled entities, jointly controlled entities and associates either:
 - (a) at cost; or
 - (b) in accordance with the Standard of GRAP on *Financial Instruments* (GRAP 104).
- .13 If an entity measures such an investment at cost in accordance with paragraph .12, it shall measure that investment at one of the following amounts in its first separate statement of financial position prepared using Standards of GRAP:
 - (a) cost determined in accordance with GRAP 6; or
 - (b) deemed cost if information about the cost of the investment is not available. The deemed cost of such an investment shall be its fair value (determined in accordance with GRAP 104) at the measurement date.
- .14 If an entity uses a deemed cost in its first statement of financial position prepared using Standards of GRAP or in the financial statements following a transfer of functions or a merger for an investment in a controlled entity, jointly controlled entity or associate in its separate financial statements, the entity's first separate financial statements or the financial statements following a transfer of functions or a merger, shall disclose:
 - (a) the aggregate of those investments valued using deemed cost; and
 - (b) the aggregate adjustment to the carrying amounts previously reported.

Effective date

- .15 The effective date of this Directive is determined by reference to the effective date of the applicable Standards of GRAP, as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Appendix

This appendix is an integral part of this Directive.

Use of deemed cost for property, plant and equipment, investment property, intangible assets, heritage assets, and living resources

- A1. An entity uses deemed cost for an item of property, plant and equipment, an investment property, an intangible asset, a heritage asset, or a living resource using fair value at the date of adopting the Standards of GRAP where information about the acquisition cost of an asset is not available. The deemed cost provisions outlined in this Directive are applied on an asset by asset basis.
- A2. The provisions outlined in this Directive should also be applied in determining the acquisition costs of assets acquired in a transfer of functions between entities under common control or in merger where:
- (i) the transferor or combining entity did not apply Standards of GRAP on the transfer date or the merger date; and
 - (ii) when information about the historical cost of those assets are not available.
- A3. Deemed cost, using fair value at the date of adopting the Standards of GRAP or on the transfer date or the merger date, is determined as follows:
- (a) The fair value of items of property, plant and equipment is determined using paragraphs .35 to .38 of GRAP 17. For specialised items of property, plant and equipment, e.g. infrastructure assets, an entity may use depreciated replacement cost as deemed cost.
 - (b) The fair value of investment properties is determined using paragraphs .49 to .68 of GRAP 16. If an investment property is of such a specialised nature that market based evidence of fair value is not available, an entity may use depreciated replacement cost as deemed cost.
 - (c) The fair value of intangible assets is determined using paragraphs .77 to .78 of GRAP 31. As intangible assets can only be measured at fair value using a price in an active market, under the revaluation model in GRAP 31, an entity cannot use depreciated replacement cost as deemed cost.
 - (d) The fair value of heritage assets is determined using paragraphs .38 to .48 of GRAP 103. An entity may use replacement cost as deemed cost.
 - (e) The fair value of living resources is determined using paragraphs .50 to .58 in GRAP 110.
- A4. The deemed cost determined in terms of paragraph A3 should be presented on a gross basis and not be off-set against other amounts.

- A5. For the purposes of this Directive, the measurement of assets at fair value on the adoption of the Standards of GRAP on the transfer date or the merger date, does not constitute:
- (a) a revaluation in accordance with GRAP 17, GRAP 31, GRAP 103, or GRAP 110; or
 - (b) the application of the fair value model in GRAP 16.
- A6. Subsequent depreciation, if applicable, is based on that deemed cost and starts from the measurement date.

Use of deemed cost for investments in controlled entities, jointly controlled entities and associates

- A7. An entity may elect to use cost in its separate financial statements for an investment in a controlled entity, jointly controlled entity or associate. Where information about the cost of the investment is not available, an entity uses a deemed cost. Deemed cost is the fair value of the investment at the date an entity adopts the Standards of GRAP on the transfer date or the merger date, and is determined using GRAP 104.

Initial entries using deemed cost on adopting Standards of GRAP

- A8. When an entity initially measures assets on adopting Standards of GRAP using the deemed cost approach in this Directive, it recognises the effect:
- (a) as an adjustment to the opening balance of accumulated surplus or deficit in the opening statement of financial position prepared using Standards of GRAP; or
 - (b) in revaluation surplus if an entity adopts the revaluation model in GRAP 17, GRAP 31, GRAP 103, or GRAP 110.

Effective date

- A9. The effective date of this Directive coincides with the effective dates of the relevant Standards of GRAP, as determined by the Minister of Finance.
- A10. If an entity has assets that it previously could not recognise and/or measure in accordance with the Standards of GRAP on their initial adoption on the transfer date or the merger date because information about the acquisition cost of the assets was not available, an entity applies this Directive to those assets. The fair value of those assets is determined at the date of adopting the Standards of GRAP on the transfer date or the merger date in accordance with paragraph A3 of this Directive.