

17 May 2004

Powerco Limited
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Attn: Mr N Barbour
Legal Counsel

Dear Nigel

Accounting Treatment of Easements

In accordance with your request we set out below a brief analysis relating to the accounting treatment of easement rights and in particular address the question as to whether the nature of these assets is tangible or intangible.

Accounting Definitions

The definition of an intangible asset is set out in International Accounting Standard (“IAS”) number 38 (Revised) which states:

“An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.”

There is no equivalent definition of a tangible asset, although various characteristics of property, plant and equipment are set out in IAS 16 (Revised), which are discussed below.

Summary of Position

Our view is that easements are intangible rights associated with the land to which they attach.

The current New Zealand practice is that easements would be treated as tangible assets as a result of reference to resource consent costs forming part of property, plant and equipment in Financial Reporting Standard 3.

We believe that this inconsistency will be tidied up with the current harmonisation of New Zealand accounting standards with international standards.

Background to Our Position

In relation to tangible assets, IAS 16 (Revised) sets out the elements of cost of property, plant and equipment in paragraph 16 as comprising:

“(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.”

Paragraph 11 of the standard states that:

“Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.”

We believe that these two paragraphs taken together have brought about the New Zealand accounting position that rights attaching to an asset, such as resource consents, forms part of the tangible asset, which is recognised in FRS3. This specific recognition in FRS is not part of the recently released NZ exposure draft of NZ IAS 16.

In its discussion of intangible assets IAS 38 (Revised) in paragraph 44 states that:

“In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as....**or rights to access other restricted resources**” (emphasis added).

By their nature, easements are “without physical substance” and are therefore considered to be intangible, rather than tangible.

We believe that the consideration of these clauses makes it clear that:

- Rights to access are intangible (even though they may attach to certain tangible assets and in particular land);
- Intangible assets can have a fixed life, just as a patent does in respect of intellectual property rights; and
- Costs incurred on relation to property plant and equipment in relation to environmental matters need to be of a tangible nature themselves in order to meet the criteria set out above in paragraph 11 of IAS 16 (Revised).

We trust that this information is sufficient. Please feel free to contact me should you wish to discuss this matter further.

Yours sincerely



Trevor Deed
Partner