Depreciation and Amortisation		Longreach Regional Council
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Policy Category:	Financial	
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PURPOSE

This non-current asset policy describes the framework and principles underlying the depreciation and amortisation of all classes of assets.

OBJECTIVE

The objectives of this policy are:

- Ensure Longreach Regional Council (Council) complies with all relevant legislation and is closely aligned with Queensland Treasury's Non-Current Asset Policies.
- Manages its assets in a sustainable manner and for the purpose of delivering services.
- Prepares financial statements that present a fair and true representation of Council's financial position.

LEGISLATION

Local Government Act 2009 (Act)

Local Government Regulation 2012 (Regulation)

Australian Accounting Standards

REFERENCES

Queensland Treasury Non-Current Asset Policies (NCAP).[1]

Australian Accounting Standards

Council's Strategic Asset Management Plan

DEFINITIONS AND CONCEPTS

Depreciation	• The systematic allocation of the depreciable amount of an asset over its useful life.
Amortisation	• The systematic allocation of the depreciable amount of an intangible asset over its useful life.

EXCLUSIONS FROM DEPRECIATION AND AMORTISATION

The following assets are not depreciated or amortised:

- inventories, as they are held at lower of cost and net realisable value;

[1] This policy has been derived from this document and amended to suit Council's circumstances.

- non-current assets whilst classified as held for sale or while they are part of a disposal group classified as held for sale (Refer AASB 5 *Non-Current Assets Held for Sale and Discontinued Operations*, paragraph 25);
- an intangible asset with an indefinite useful life (Refer AASB 138 paragraph 107);
- investment property accounted for under the fair value model (refer AASB 140 *Investment Property* paragraphs 76 and 79);
- land, where its service potential is not expected to diminish with time or use (refer AASB 116, paragraph 58);
- work in progress assets, as depreciation only begins when an asset is available for use i.e. in the location and condition necessary for it to be capable of operating in the manner intended by management (refer AASB 116, paragraph 55).

Criteria for the Recognition of Depreciation Expense

The criteria for the depreciation of a non-current physical asset are that the asset has a cost that can be depreciated i.e. a depreciable amount, and it has a useful life that can be estimated.

Concept of 'Depreciable Amount'

AASB 116 defines 'depreciable amount' as "*the cost of an asset, or other amount substituted for cost, less the residual value.*

AASB 116 defines 'useful life' as "*the period over which an asset is expected to be available for use by an agency"* or "*the number of production or similar units expected to be obtained from the asset by an agency."*

Residual value is defined in AASB 116 as "*the estimated amount that an entity would currently obtain from the disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life*."

For the avoidance of doubt, residual value **does not include** expected cost savings from reuse of part of an asset.

Example – Depreciable Amount

If an agency purchased an asset with a limited life for $30,000 and the amount expected to be recovered when it is disposed of by the agency is nil, the depreciable amount is $30,000. If the residual value expected to be recovered at the end of the asset's useful life is $5,000, the depreciable amount would be $25,000

Concept of the 'Useful Life' of an Asset

The following factors are relevant in determining the useful life of non-current physical assets:

- expected usage of the asset i.e. its output;
- expected physical wear and tear, although a planned maintenance program may extend the useful life;
- technical or commercial obsolescence e.g. technological innovations in newer, similar assets may render an asset's useful life shorter than what might have otherwise been the case; and

- legal or similar limits on the use of an asset such as the expiry date of related leases, or compulsory replacement of assets for safety reasons e.g. aircraft, elevators.

In addition, and most importantly, the estimation of useful life should be based on Council's past experience and its realistic planned replacement program as outlined in its asset planning. Tensions often exist between the replacement timeframes estimated by engineers and those in which fiscal provision has been made for asset replacement. If an asset is expected to be used by Council beyond an 'ideal' or 'optimum' replacement timeframe, the extended period is the useful life which should be used. This assessment is a matter requiring professional judgment to be exercised at each reporting date.

The useful life of a depreciable asset to one entity may well differ from the useful life to another entity or even within the same entity as a result of differing use or service requirements e.g. the estimated life of sensitive technical equipment in North Queensland may well be less when compared to similar equipment located in Brisbane, due to climatic differences.

The useful life of an asset to an agency may be shorter than its economic life.

Example – Useful Life

An agency has been depreciating its servers over a 3 year timeframe using the straight line basis as their method of depreciation. A review of useful lives indicated that servers have typically been in service in the agency for 5 years. On this basis, the annual depreciation rate should be adjusted over the remaining period with the asset having a total useful life of 5 years. Worked examples of such changes are demonstrated in NCAP 5.5.

Where an asset is planned to be sold to another entity, such an intention should not itself impact on existing estimates of remaining useful life and residual value. This is consistent with the cessation of depreciation when an asset becomes classified as 'held for sale' - there is an expectation that there should be a carrying amount for assets classified as 'held for sale'. For example, if the remaining useful life was re-assessed to fully depreciate the asset by the date of sale, the depreciable amount would probably be reduced to zero by sale date. This is not considered logical, as it would likely result in a sudden large increase in depreciation together with a potentially large profit on sale.

Recognition

Depreciation expense commences from the time the asset is first put into use or held ready for use (usually from the end of the relevant month). Where an asset is a complex structure made up of interdependent sub-structures which require installation in successive stages, it must be considered as being held ready for use only after installation has been completed to a stage where service or a saleable product can be obtained.

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with AASB 5 *Non-Current Assets Held for Sale and Discontinued Operations* and the date that the asset is derecognised.

Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

Depreciation basis

Council will use the time basis to depreciate its assets over their useful lives. Using the time basis, the useful life of an asset is determined by the following factors:

- expected physical wear and tear;
- obsolescence (both technical and commercial); and
- legal and other limits on the use of the asset.

The useful life of an asset is normally the shortest of the applicable alternatives. As an example, computer hardware may have a physical life of ten years but become technically obsolete within five years. In this case the appropriate life is five years provided replacement is based on technical obsolescence. Should Council decide to use a non-current physical asset beyond the ideal or optimum replacement timeframe, then the depreciable amount should be allocated over the longer period.

Depreciation method

Council will adopt the straight line method of depreciation. The straight line method allocates the depreciable amount in approximately equal amounts in each accounting period over the useful life of the asset being depreciated.

Example – Straight Line Method

If an asset had a cost of $20,000, a residual value of $2,000 and a useful life of five years, an amount of $3,600 would be recorded each year as depreciation under the straight-line method [(20,000-2,000)/5].

Changes in depreciation

Depreciation policies, including the method of depreciation, must be applied consistently and accurately reflect the pattern of consumption of economic benefits to be delivered by the asset over its estimated useful life to the agency.

AASB 116 requires that the residual value and the useful life of an asset be reviewed **at least** at the end of each annual reporting period. If expectations differ from previous estimates (i.e. expectations with respect to the depreciable amount or the useful life of the asset) the consequential change in the rate of depreciation is to be accounted for as a change in an accounting estimate in accordance with paragraphs 32-38 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors.*

Adjustments to the estimated useful life must be made in the earliest year in which a change is deemed necessary. This will achieve an allocation of cost that most closely aligns with the consumption of the asset. Delaying adjustments to estimated useful life to when the asset is close to becoming fully depreciated are to be avoided, wherever possible.

Example

Agency XYZ has established a process where a report is generated a few months prior to the end of each financial year to review remaining useful life estimates. While the estimated useful life of all estimates is carefully reviewed, particular attention is focussed on those assets where 75% or more of the asset's estimated useful life has elapsed.

XYZ then conducts an independent review to assess whether the useful lives indicated on the report are an accurate reflection of how long the agency estimates it will use the assets and makes any necessary adjustments to the assets useful lives. Should any assets listed on the report be used in the regions, the respective persons in each of the regions are consulted prior to any necessary adjustments being made.

This process not only meets the requirement of paragraph 51 of AASB 116 which requires at least an annual review of the residual value and useful life of an asset, but also mitigates against assets still in use being fully depreciated.

Any change in the calculation of depreciation as a result of the annual review of useful life and residual value will be a change in accounting estimate and adjusted **prospectively**. A material change in consumption requiring the method to be changed is also treated as a change in an accounting estimate. Disclosure must be made in accordance with the requirements of AASB 108.

Corrections of errors are distinguished from changes in accounting estimates. Where depreciation has been incorrectly calculated in a prior year based on estimates that were made in that prior year, this should be treated as an error and corrected **retrospectively** in accordance with AASB 108. Judgements about estimates that should have been (but weren't) made in a prior year must not be used for the purpose of 'error correction'.

Example - Straight Line Method

A machine was purchased on 1 July 20X0 for $100,000. The estimated useful life is ten years with a residual value of zero. The machine is depreciated on a straight line basis.

On 30 June 20X4, after charging four years depreciation (4 x $10,000 = $40,000), it was decided that the machine's remaining useful life to the agency would be a further 12 years.

In this instance, there would be no adjusting journal entry at 30 June 20X4, as retrospective adjustments to depreciation are not permitted. However, the journal entry to record the depreciation expense in subsequent years would be:

Depreciation expense – machinery	Dr	5,000	
Accumulated depreciation – machinery			Cr 5,000

The undepreciated amount ($100,000 - $40,000) of the asset is depreciated according to a remaining useful life of 12 years from the date of the change.

Re-Lifing Fully Depreciated Assets

Where an asset is carried at cost, should it transpire that the asset still has some useful life after it has been fully depreciated, re-lifing or revaluation of the asset is **not** permitted.

Where an asset is carried at fair value, the revaluation process should ensure an asset will not still have some useful life after it has been fully depreciated.

Where large numbers of assets are fully depreciated and are still in use, a review of the depreciation rate or annual review processes may be warranted. Annual reviews of non-current physical assets should ensure that a situation will not arise where fully depreciated assets are still in use.

Disaggregation of Assets for Depreciation

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item and has a materially different useful life is to be depreciated separately.

Some assets, for example a power station, may consist of a number of integral components that will function only when all components are combined. Discrete components of the asset may have different useful lives and different methods and rates of depreciation. The Complex Assets Policy contains detailed criteria for the identification of significant components.

Subsequent Costs

Costs incurred subsequent to a non-current physical asset first having been put into use, or held ready for use, must be added to the carrying amount of that asset and depreciated, *where it is probable that future economic benefits will occur, in excess of the originally assessed performance of the asset.* Subsequent costs which have been capitalised shall be depreciated over the remaining useful life of the asset to which they relate.

These increased future economic benefits can result from an increase in the annual output of the asset, or an increase in its useful life or both. An example is the modification of an item of plant to extend its useful life or increase its capacity thereby increasing the service potential of the asset.

Spares

Major spare parts and standby equipment may qualify as property, plant and equipment when an agency expects to use them during more than one period. Where such spares are used only in connection with a particular asset and do not have a separate useful life to the asset, they must be depreciated over the useful life of the asset. Spares are distinguishable from stores and supplies which are normally consumed on an ongoing basis. Stores and supplies are to be recognised in terms of AASB 102 *Inventories.*

Revaluations and Accumulated Depreciation/Amortisation

Council adopts the gross method of revaluation for most of its appraisals using a cost (e.g. depreciated replacement cost) approach.

Example 1 – Revaluation increase (gross method)

An item of Major Plant and Equipment was purchased for $100,000 with a residual value of $10,000 and was to be depreciated at 10% straight line. After three years, the asset's written-down value is $73,000, after accumulated depreciation of $27,000. The asset's fair value was determined to be $85,000 using the depreciated replacement cost technique. The gross replacement cost of the asset, as determined by the valuer, has increased to $120,000 with the residual value and useful life being assessed as remaining the same.

1. General ledger entries to recognise revaluation:

Major plant & equipment asset	Dr	20,000		
Accumulated depreciation			Cr	8,000
Asset revaluation surplus			Cr	12,000

(Revaluation of major plant and equipment from $73,000 to $85,000 WDV)

Calculation of restated Accumulated Depreciation:
New gross replacement cost – new fair value: 120,000 - 85,000 = 35,000

2. Annual depreciation until next revaluation:

Depreciation expense	Dr	10,714		
Accumulated depreciation			Cr	10,714

(Record annual depreciation until next revaluation)

Calculation of annual depreciation until next revaluation: (85,000 - 10,000)/7 = 10, 714

Example 3 – Revaluation decrease (gross method)

An item of Major Plant and Equipment was purchased for $100,000 with a residual value of $10,000 and was depreciated at 10% straight line. After three years, the asset's written-down value is $73,000 after accumulated depreciation of $27,000. The asset's fair value was determined to be $50,000 using the depreciated replacement cost technique. The gross replacement cost of the asset, as determined by the valuer, has decreased to $80,000 with the residual value and useful life being assessed as remaining the same.

1. General ledger entries to recognise revaluation:

Asset revaluation surplus	Dr	23,000		
Major plant & equipment asset			Cr	20,000
Accumulated depreciation			Cr	3,000

(Revaluation of major plant and equipment from $73,000 to $50,000 WDV, adjusted against ARS if that class has sufficient credit ARS balance (to extent that ARS credit balance for class is insufficient, recognise as expense in Statement of Comprehensive Income))

Calculation of restated Accumulated Depreciation:
New gross replacement cost – new fair value : 80,000 - 50,000 = 30,000

2. Annual depreciation until next revaluation:

Depreciation expense	Dr	5,714		
Accumulated depreciation			Cr	5,714

(Record annual depreciation until next revaluation)

Calculation of annual depreciation until next revaluation: (50,000 - 10,000)/7 = 5,714

Example 5 – Revaluation increase (gross method) plus change in useful life

An item of Major Plant and Equipment was purchased for $100,000 with a residual value of $10,000 and was to be depreciated at 10% straight line. After three years, the asset's written down value is $73,000 after accumulated depreciation of $27,000. Using the depreciated replacement cost technique, the valuer has determined that the gross replacement cost of the asset has increased from $100,000 to $120,000. The residual value is assessed to remain the same, but the remaining useful life of the asset has been reassessed to be 9 years (i.e. a total useful life of 12 years). Given the increase in gross replacement cost, plus the increase in the asset's useful life, the valuer has determined the asset's fair value to be $92,500.

General ledger entries to recognise revaluation:

Major plant and equipment asset	Dr	20,000			
Accumulated depreciation			Cr		500
Asset revaluation surplus			Cr		19,500

(Revaluation of major plant and equipment from $73,000 to $92,500 WDV)

Calculation – restated Accumulated Depreciation:
New gross replacement cost – new fair value: 120,000 – 92,500 = 27,500

Annual depreciation until next revaluation:

Depreciation expense	Dr	9,167			
Accumulated depreciation			Cr		9,167

Calculation:
Annual depreciation until next revaluation: (92,500 - 10,000)/9 = 9,167

Example 6 – Indexation (gross method)

An item of Major Plant and Equipment was purchased for $100,000 with a residual value of $10,000 and was to be depreciated at 10% straight line. After three years, the asset's written-down value (based on a depreciated replacement cost technique) is $73,000, after accumulated depreciation of $27,000. Indexation is applied in year 4 using a published construction cost index. The percentage change in the index since the previous year's specific appraisal is 3.5%. The asset's residual value and remaining useful life are assessed as remaining the same.

Calculation – restated Gross and Accumulated Depreciation (indexation applies consistently to both gross and accumulated depreciation):

*Gross amount: 100,000 * (1+0.035) = 103,500*
*Accumulated Depreciation: 27,000 * (1+0.035) = 27,945*
Net Written-down value: 103,500 – 27,945 = 75,555

1. General ledger entries to recognise revaluation using indexation:

Major plant and equipment asset	Dr	3,500		
Accumulated depreciation			Cr	945
Asset revaluation surplus			Cr	2,555

(Revaluation of major plant and equipment by indexation of 3.5%)

2. Annual depreciation until next revaluation:

Depreciation expense	Dr	9,365		
Accumulated depreciation			Cr	9,365

(Record annual depreciation until next revaluation)

Calculation of annual depreciation until next revaluation: (75,555 - 10,000)/7 = 9,365

Amortisation of Intangible Assets

The depreciable amount of an intangible asset with a finite useful life is to be amortised on a systematic basis over the useful life of the asset.

An intangible asset with an indefinite useful life is not amortised. The term 'indefinite' does not mean 'infinite'. It is unlikely that an agency would have an intangible asset with an infinite useful life. On the other hand, an agency may well have an intangible asset which, at the time it is developed, has an indefinite useful life e.g. the intellectual property associated with a vaccine that brings a significant disease under control. Such an intangible asset would not be amortised but would be tested for impairment at each reporting period.

Similar to depreciation, amortisation is usually recognised in profit or loss but may be absorbed into the carrying amount of other assets e.g. amortisation of intangible assets used in the production process could be included in the carrying amount of inventories.

Also similar to depreciation, the amortisation method for an intangible asset with a finite life is to be reviewed at least at the end of each annual reporting period. The useful life of all intangible assets should be assessed annually (even intangibles with indefinite lives – to confirm they continue to be indefinite).

Road Earthworks

In some circumstances, the service potential of road earthworks is expected to be retained due to the absence of any events that may cause physical deterioration e.g. excessive usage, flooding or land movement, and the earthworks are not expected to become obsolete in the foreseeable future. Such assets, due to their unlimited useful life, are not

subject to depreciation. Where management have assessed and assigned a useful life to road earthworks, this asset is depreciated.

It is necessary for Council to assess which of its road earthwork assets do not have limited useful lives and which do have limited useful lives.

The depreciation or non-depreciation of road earthworks assets are to be reviewed at least at each reporting date to ensure that the accounting policy applied reflects the most recent assessment of the useful lives of the assets.

Authorised by resolution as at 12 December 2024:

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Chief Executive Officer