

ASSET ACCOUNTING POLICY

GUIDELINE 3: DEPRECIATION AND AMORTISATION

Version 1.0

Location of Controlled Copies:	Electronic version is the only Controlled copy (ECM 7996675)
Document Reviewer:	N/A
Approved By:	Council
Next review date:	30/06/2022

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1.0 PURPOSE

This guideline is intended to support the Asset Accounting Policy. It provides additional explanations on accounting for the periodic consumption of all depreciable assets recorded in the fixed asset register.

2.0 DEPRECIATION AND AMORTISATION METHODS

NZ GAAP requires the depreciable amount of an asset (including intangible assets) to be systematically expensed over the asset's useful life based on its pattern of consumption. Depreciable amount equates to the cost or fair value of an asset less its estimated residual value.

In accordance with NZ GAAP, depreciation or amortisation of an asset begins when it is available for use. That is, when it is in the location and condition necessary for it to be capable of operating in the manner intended.

The depreciation or amortisation method used should be the one that best reflects the respective asset's pattern of consumption. Methods allowable under NZ GAAP are:

- **Straight line** - depreciation or amortisation is charged evenly to each accounting period over an asset's useful life.
- **Diminishing value** - amount of depreciation or amortisation recognised for an asset each accounting period progressively reduces over its useful life.
- **Units of production** - amount of depreciation or amortisation recognised each accounting period can differ and is dependent on an asset's actual or deemed usage.

Of the three depreciation methods, straight line is considered the most appropriate for the Council's assets, as well as being the easiest to administer.

The straight line depreciation/amortisation method is used to reflect patterns of consumption for all non-current assets other than land and restricted assets which are not subject to depreciation (parks and reserves land, museum collections, Govett-Brewster collections).

Theoretically, the units of production method could apply to plant and infrastructure assets such as road and sewerage networks however a current lack of available data would result in difficulties satisfying external audit scrutiny. Future use of the method is possible but would come at a cost due to resources required to collect the necessary data.

3.0 STRAIGHT LINE FORMULA

The straight line formula is applied as follows:

$$(\text{Net Book Value} - \text{Residual Value}) / \text{Remaining Useful Life}$$

4.0 USEFUL LIFE

The useful life of an asset or asset component is determined by its expected use by the Council and provides the basis for systematically allocating straight line depreciation or amortisation. Useful life must be based on the physical asset or component in service and not the useful life of any modern equivalent.

Useful life may be less than an asset's design life or economic life. For example, a bridge may be replaced when it reaches a certain condition rating, notwithstanding that the bridge could continue to be used for a further period of time.

Given the direct correlation to depreciation and amortisation, useful lives must be carefully considered to ensure the financial statements provide relevant information consistent with financial reporting requirements.

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The following should be considered when establishing the useful life of an asset:

- **Design life** – period of time over which the asset can be expected to last physically, assuming adequate maintenance.
- **Technical life** – period of time over which the asset can be expected to remain effective due to obsolescence.
- **Economic life** – period of time the Council intends to use the asset before disposal or decommissioning based on optimal economic factors. For example, replace a pool vehicle prior to being four years old.
- **Legal life** – period of time an asset can be used based on restrictions imposed by legal agreement, legislation or government decree.

The Council has adopted estimated useful lives for different asset types within each asset class, which for many asset classes are set out in the relevant asset workbooks.

Furniture, fittings and equipment, and software asset lives are determined by considering the nature and intended use of the asset.

These useful lives may vary where it is considered that the recommended useful life is inappropriate for a specific case. In these circumstances, relevant council staff must provide clear documentation to justify the deviation from recommended useful lives. This may be the recommended manufacturer specifications.

The estimated useful lives disclosed in the financial statements are:

Asset class	Estimated useful lives
Buildings/improvements	20 to 100 years
Roading	5 to 100 years
Waste management and minimisation	35 to 100 years
Stormwater	50 to 140 years
Flood protection	50 to 200 years
Water	10 to 120 years
Wastewater	10 to 140 years
Puke Ariki book collection	2 to 15 years
Vehicles	3 to 30 years
Furniture, fittings and equipment	3 to 10 years
Laboratory	8 to 30 years
Computer software	3 to 5 years

5.0 REMAINING USEFUL LIFE

The remaining useful life of an asset represents the period of time expected to elapse until the asset is removed from service. At the time the asset is placed in service, the useful life and remaining useful life will be the same. Remaining useful life will subsequently decrease over time as the asset is used and depreciated/amortised.

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The remaining useful life of an asset should be reassessed whenever:

- Significant value is added to an asset following initial recognition.
- A major component, section or part of an asset is derecognised.
- There has been a significant change to an asset's condition.
- An asset is removed from service at a stipulated future date.
- Technical or commercial obsolescence factors become known.
- There have been indicators of impairment impacting on the asset (refer to [Guideline 5](#)).
- There are legal obligations or environmental factors impacting on the asset.

6.0 RESIDUAL VALUE

Residual value is defined as the estimated amount that would be obtained today from the disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and condition expected at the end of its useful life.

For assets expected to be sold or traded at the end of their useful life, the Council is required to estimate residual value by giving consideration to salvage or scrap values as well as to second hand market values.

A residual value based on salvage or scrap principles should only be allocated to an asset whenever there is some certainty on its condition at the end of its useful life. This precludes the allocation of residual value to most of the Council's depreciable asset types due to their long life nature.

Common exceptions are certain items of plant and equipment, which are retained for a stipulated short term period before being traded or sold.

In addition to the difficulties in ascertaining the condition of infrastructure assets at the end of their useful life, any allocation of residual value to most infrastructure asset types is considered illogical. Infrastructure assets by their very nature do not have a resale or trade-in value and when decommissioned they are generally left in place or removed at considerable cost. The cost of decommissioning most infrastructure assets will ultimately outweigh any potential scrap value.

7.0 PERIODIC REVIEW OF DEPRECIATION/AMORTISATION RATES, REMAINING USEFUL LIVES AND RESIDUAL VALUE

The depreciation or amortisation method applied to an asset must be reviewed regularly to ensure that its pattern of consumption is accurately reflected in the annual financial statements.

Useful lives and condition ratings (and hence, remaining useful lives) of assets must be reviewed regularly to ensure that they accurately reflect the rate of depreciation/amortisation reported the Council's financial statements.

The remaining useful life of an asset should be reassessed whenever a major addition or any significant partial disposal is processed.

Council staff who possess relevant technical expertise and knowledge will be required to certify and substantiate their estimates. Where this is not available within the Council, external expertise will be required to assist in undertaking the assessments.

8.0 GUIDELINE REVIEW

The guideline is to be formally reviewed on a triennial basis in conjunction with Asset Accounting Policy review.

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