Public sector: Treatment of fully depreciated assets still in use

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The treatment of fully depreciated assets is a contentious issue in the public sector space. Many public sector entities utilise assets beyond their accounting useful lives because of issues such as budget constraints. This article highlights the main issues surrounding fully depreciated assets and how the Accounting Standards Board (ASB) has set out to address these issues.

To whom does the standard apply?

The standard applies to all categories of public sector entities and addresses the treatment of fully depreciated assets in the public sector space.

(a) When is an adjustment required to the financial statements?

In terms of GRAP 17 Property, Plant and Equipment, an entity is required to assess the appropriateness of the useful lives, residual values and depreciation methods of assets at every reporting date. As a result, if an entity has fully depreciated assets at the reporting date that it intends using in future periods, appropriate adjustments (as discussed in question (c) below) should be made to the financial statements.

It may be appropriate, in rare instances, for an entity to hold fully depreciated assets which it still uses. If an entity made an appropriate estimate of the useful lives, residual values and depreciation of an asset based on the information available at the previous reporting dates, it continues to measure the assets at R0, and considers whether disclosure of the fact that it has fully depreciated assets still in use is appropriate.

The instances when an entity would be allowed to follow this approach (i.e. retain as fully depreciated and disclose where appropriate) would be very rare and would be limited to assets that are not significant to an entity's operations. If the nature of the assets is significant to an entity's operations and service delivery objectives appropriate adjustments (as discussed in question (c) below) will need to be made.

(b) What information should be used to assess the useful lives of assets?

In preparing the financial statements, all relevant facts and circumstances should be considered by the entity. This would include the technical information received from engineers about the performance, maintenance and replacement of assets, financial and other information available. To illustrate, an engineer may indicate that a particular asset can only be used, as a result of certain performance and safety specifications, for another year. Relevant financial information available indicates that the planned replacement of this asset, along with the relevant funding, will only be available in 3 years. Knowing that the asset will be used until replacement funding is available, the 3 year period should be used to depreciate the asset rather than the 1 year period.

(c) Is the adjustment a change in estimate or an error?

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

An entity is required to assess the appropriateness of the useful lives, residual values and depreciation methods of assets at every reporting date. Where an entity has fully depreciated assets because it did not appropriately apply the principles of GRAP 17, either because it did not review the useful lives or residual values of assets at previous reporting dates, or because it did not use available information appropriately, this results in an error in accordance with GRAP 3.

If the requirements of GRAP 17 were correctly applied in prior periods, but expectations changed after year end, then the adjustment will result in a change in accounting estimate (i.e. an adjustment to depreciation) and not an error. However, if the requirements of GRAP 17 were not correctly applied in prior periods, the adjustment results in an error in accordance with GRAP 3.

Whether adjusting for a change in an accounting estimate or an error, the disclosure requirements in GRAP 3 should be applied.