

Managing for Outcomes >

>> Depreciation Policy Paper

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Purpose

The purpose of this paper is to differentiate between the policies relating to the accounting treatment of depreciation expense and the funding of depreciation expense. The paper also outlines the funding options which may be applied in dealing with increases in depreciation expense that arise for a variety of reasons including acquisition of assets, asset revaluations, changes in the useful lives of assets and donated assets.

Depreciation policies fall into two categories:

- Accounting policies related to determination of depreciation expense
- Funding of depreciation expense

Depreciation Expense Accounting Policy

To ensure that Government's assets are appropriately managed and that depreciation expense is appropriately accounted for in financial and management reporting, agencies should have regard to the following accounting policies and guidelines.

- Charter of Social and Fiscal Responsibility
- Financial Administration and Audit Act 1977
- Financial Management Standard 1997
- Agency Financial Management Practice Manuals
- Non-Current Asset Accounting Guidelines for the Queensland Public Sector
- Relevant Australian Accounting Standards
- Capital Investment Strategic Planning Guidelines
- Treasury Financial Circulars

The efficient and effective management of State Public Sector non-current assets is essential to the delivery of the Government's obligations as set out in its Charter of Social and Fiscal Responsibility. Under the Financial Administration and Audit Act 1977, each accountable officer and statutory body is responsible for managing the entity efficiently, effectively and economically. The Financial Management Standard 1997 establishes minimum requirements for asset management, including the preparation of asset strategic plans and the development and implementation of policies and practices about asset management that must be

incorporated in agency Financial Management Practice Manuals. The Capital Investment Strategic Planning Guidelines describe and intend to provide guidance on asset strategic planning and the process involved.

The Non-Current Asset Accounting Guidelines for the Queensland Public Sector incorporate relevant provisions of the Australian Accounting Standards and exist to explain the policy framework for the recording, recognition, valuation and depreciation of non-current assets, including intangibles, in the Queensland Public Sector.

Treasury Financial Circulars are regular bulletins designed to inform agencies of Treasury's budgeting, budget monitoring and financial reporting requirements. In particular the Circulars dated 19 December 2000, 30 May 2001 and 11 September 2001 cover requirements relating to depreciation expense.

A thorough understanding of these policies and guidelines will ensure the agency is adequately informed about and can plan for the recurrent costs associated with new assets or increased asset values.

Depreciation Expense Funding Policy

The cost of depreciation is a non-cash cost that comprises a part of the funded output cost. The objective of funding depreciation is to recognise the accrual cost of the delivery of agreed outputs, with agencies using the cash to fund CBRC approved capital acquisitions. Approved capital acquisitions are funded from a number of sources which could include output funding for depreciation (net of any equity withdrawals), equity injections, approved borrowings (if any) and an agency's own sourced funding. If an agency's approved capital program is less than the accrual cost of depreciation, equity withdrawals will adjust capital funding to the appropriate level.

As depreciation is a non-cash expense, Government does not automatically fund increases in depreciation expense relating to revaluations or asset acquisitions. Increased output funding to offset increased depreciation expense is a matter for CBRC determination in the relevant budget context. In considering the appropriate level of output funding CBRC will have regard to the funding requirement (and other funding options)



necessary to deliver capital projects listed on the agency's approved capital acquisition plan.

There are two key factors that may lead to an increase in depreciation expense above the budget-funded amount.

1. Acquisition of an Asset

Where an agency acquires an asset from within its existing resources, it is expected to meet the operating cost associated with the purchase of that asset. Where it is unable to meet the operating cost from within existing resources, the agency may seek supplementation from CBRC.

Where an agency seeks funding from CBRC for the acquisition of an asset, it may also seek funding for the operating costs associated with this asset. However, supplementation of the associated operating costs is not automatic. There may be instances where CBRC determines that supplementation of depreciation expense for an asset is not warranted. An example of this may be where the asset the agency intends to purchase is to be used to replace an existing asset for which depreciation has already been fully funded (and there has been little change in price).

2. Accounting Policies

Supplementation of depreciation expense is considered independently of the accounting determination of depreciation expense. Where there is an increase in depreciation expense as a result of Government accounting policies, it does not automatically lead to supplementation of this expense, just the same as increases in any other input cost does not automatically trigger supplementation. CBRC approval of supplementation is required and will be assessed on a case-by-case basis. As output funding for depreciation is applied to approved capital projects, increased funds will be provided if required to deliver priority capital projects approved by CBRC.

In accordance with the Financial Circular of 11 September 2001, agencies are required to budget

for asset revaluations and their consequent effect on depreciation expense by using the CPI index of 2.5%. Such adjustments to the balance sheet and any consequential flow-on effects to the agency's operating statement are to be managed within the existing forward estimates.

An increase in depreciation expense above the budget-funded level may be dealt with a number of ways. Agencies may:

1. reduce depreciation (for example by selling other assets) or other expenses to offset the impact of the increased depreciation expense.
2. request supplementation from CBRC to fund the increase in depreciation expense in order to meet approved capital acquisitions.
3. run an operating deficit to the extent of the increased depreciation expense.
4. swap funding from equity to outputs to meet the increased depreciation expense.

It should be noted that 2, 3 and 4 all require the prior approval of CBRC as they each have an impact on the Whole-of-Government operating position. In summary, agencies have only two options for dealing with an increase in depreciation expense. These are:

Option 1 – Fund internally by reducing the depreciation associated with other assets or by reducing other operating expenses; or

Option 2 – Seek CBRC approval (a) for supplementation; (b) to run an operating deficit; or (c) swap funding from equity to outputs.

All requests for additional output or equity funding are to be determined by CBRC and supplementation provided (within the parameters of the Charter of Social and Fiscal Responsibility) where it is determined that the funding of these additional costs will best achieve the Government's Priorities.

If you have any queries regarding issues raised in this paper please contact your Treasury Analyst.

