Australian Accounting Standard **AAS 4**
August 1997

Depreciation

Prepared by the
Public Sector Accounting Standards Board of the
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on behalf of the **Australian Society of Certified Practising Accountants** and **The Institute of Chartered Accountants in Australia**

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MAIN FEATURES OF THE STANDARD

A Note on the Scope of the Standard

In broad terms, the Standard covers two aspects.

1 Recognition of assets with physical substance and which are expected to be used during more than one reporting period, which corresponds with a requirement in International Accounting Standard IAS 16 "Property, Plant and Equipment" to recognise property, plant and equipment.

2 Depreciation of all non-current assets with limited useful lives, which would include intangible assets.

Recognition of Assets with Physical Substance

The Standard requires the recognition of an asset with physical substance which is expected to be used during more than one reporting period when and only when:

(a) it is probable that the future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured reliably.

Depreciation

The Standard requires non-current assets that have limited useful lives (depreciable assets) to be depreciated over those useful lives and specifies the manner in which this is to be done.

Disclosure

The Standard requires disclosure of specified information about depreciable assets and the allocation of the depreciable amount.

AUSTRALIAN ACCOUNTING STANDARD

AAS 4 "DEPRECIATION"

1 Application

1.1 **Subject to paragraph 1.3, this Standard applies to *general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply.**

1.2 **Subject to paragraph 1.3, this Standard applies to financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.**

1.3 **This Standard does not apply:**

(a) in respect of accounting policies prescribed for *non-current assets* in other Australian Accounting Standards; and

(b) to non-current assets that are:

(i) forests, livestock or similar regenerative natural resources; or

(ii) *investment properties*.

1.3.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

1.3.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

1.3.3 Accounting policies are prescribed for particular types of non-current assets in a number of other Australian Accounting Standards, for example, goodwill in Australian Accounting Standard AAS 18 "Accounting for Goodwill" and deferred research and development costs in Australian Accounting Standard AAS 13 "Accounting for Research and Development Costs".

2 Operative Date

2.1 This Standard applies to reporting periods ending on or after 30 June 1998.

2.2 This Standard may be applied to reporting periods ending before 30 June 1998.

2.2.1 AAS 4 "Depreciation of Non-Current Assets", as issued in June 1996, continues to apply for reporting periods that end before 30 June 1998. However, where an *entity* elects to apply this Standard early in accordance with paragraph 2.2 it will not also be obliged to comply with AAS 4, as issued in June 1996, for the reporting periods to which the election applies.

2.3 When operative, this Standard supersedes Australian Accounting Standard AAS 4 as issued in June 1996.

3 Purpose of Standard

3.1 The purpose of this Standard is to:

(a) require the *recognition* of *assets* with physical substance that are expected to be used during more than one reporting period and which meet specified criteria

(b) require the consumption or loss of future economic benefits embodied in *non-current assets* with limited *useful lives* to be recognised

(c) require disclosure in the financial report of information in relation to depreciable non-current assets and the allocation of the *depreciable amount*.

3.1.1 The establishment of recognition criteria for assets with physical substance that are expected to be used during more than one period and the establishment of accounting standards for the depreciation of non-current assets will assist in ensuring that users of *general purpose financial reports* are provided with relevant, reliable and comparable information about the depreciation of non-current assets for the purposes of assessing the performance, financial position, financing and investing, and compliance of the *entity*.

3.1.2 The recognition of non-current assets without physical substance (intangible assets) is outside the scope of this Standard.

4 Recognition of Assets with Physical Substance

4.1 Subject to paragraph 4.2, an *asset* with physical substance which is expected to be used during more than one reporting period must be *recognised* when and only when:

(a) it is probable that the future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured reliably.

4.2 An *entity* may elect not to recognise assets and *liabilities* arising from agreements equally proportionately unperformed, except that, where another Accounting Standard sets out requirements for the recognition of such assets and liabilities, the requirements of that Standard must be applied.

4.2.1 In practice, assets and liabilities arising from agreements equally proportionately unperformed that would satisfy the recognition criteria set out in this Standard have usually been recognised only in respect of particular types of agreements, such as finance leases. For many other agreements, significant uncertainty may exist as to whether the definitions of, and recognition criteria for, assets and liabilities would be satisfied. In addition, substantial difficulties may arise in determining a reliable and appropriate measure for assets and liabilities which may arise from these agreements.

5 Recognising the Depreciable Amount

5.1 The *depreciable amount* of a *depreciable asset* must be allocated on a systematic basis over its *useful life*. The depreciation method applied to an *asset* must reflect the pattern in which the asset's future economic benefits are consumed or lost by the *entity*. The allocation of the depreciable amount must be *recognised* as an *expense*, except to the extent that the amount allocated is included in the carrying amount of another asset.

5.2 In estimating the useful life of a depreciable asset, consideration must be given to the following factors:

(a) expected physical wear and tear;

(b) obsolescence; and

(c) legal or other limits on the use of the asset.

5.3 The depreciable amount must be allocated from the time when a depreciable asset is first put into use or held ready for use. 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 saleable product can be obtained.

5.4 The depreciable amount of any addition or extension to an existing depreciable asset which becomes an integral part of that asset must be allocated over the remaining useful life of that asset.

5.5 The depreciable amount of any addition or extension to an existing depreciable asset which retains a separate identity and will be capable of being used after that asset is disposed of must be allocated independently of that existing asset on the basis of its own useful life.

5.5.1 The term "depreciation" is often used interchangeably with the term "amortisation". The terms have the same meaning , however, depreciation is generally used in relation to *non-current assets* that have physical substance while amortisation is generally used in relation to intangible non-current assets.

5.5.2 With the exception generally of land, a characteristic common to all physical assets (durable goods and other physical property) held on a long-term basis, is that their useful lives are limited: that is, their service potential declines over time to a point where it is, for all practical purposes, consumed or lost.

5.5.3 Factors that can contribute to this decline are:

(a) wear and tear, through physical use, in excess of that which maintenance can restore

(b) technical obsolescence, that is, the process of becoming increasingly out-of-date and, on a comparative basis, inefficient as a result of technological advances and improvements

(c) commercial obsolescence, that is, the process of becoming redundant through a fall in the market demand for the goods or services in the production of which the respective assets are used.

The possibility of obsolescence, both technical and commercial, is a factor which exists regardless of the physical use of an asset.

5.5.4 In common with physical assets, most intangible assets held on a long-term basis have limited useful lives. In the case of some, for example, lease rights, patents, trademarks, copyrights, licences and franchises, the service potential of the particular rights or entitlements will be available only for a limited term of known duration, fixed by statute or by agreement. In the case of others, for example, research and development or promotion expenditures carried forward as assets, the period of time over which the benefits from those expenditures will be available is not precisely ascertainable. Nevertheless, the nature of the benefits is inevitably such that they must be assumed to expire in time.

5.5.5 Depreciation, in this Standard, is viewed as a process of allocation, and *accumulated depreciation* in respect of any one depreciable asset is logically limited to (and cannot exceed) the depreciable amount.

5.5.6 The future economic benefits associated with non-current assets may be consumed in the process of creating other assets or adding value to other assets, such as inventories or constructed property, plant and equipment. In these circumstances, the depreciable amount is recognised as part of the carrying amount of the other assets, rather than as an expense.

5.5.7 The allocation of the depreciable amount in respect of any asset is dependent on several factors:

(a) the basis chosen for assessing the useful life of the asset, that is, either time or output, or, in some special cases, *revenue*

(b) the specific method adopted for allocating the depreciable amount

(c) the estimate, for the time being, of the net amount recoverable on ultimate disposal of the asset.

5.5.8 Most commonly, the useful life of an asset is assessed and expressed on a time basis. In determining the useful life, consideration needs to be given to the following factors in the context of the utility of the asset for the entity:

(a) in the case of physical assets, the potential physical life of the asset, that is, the period of time over which the asset can be expected to last physically, at a projected average rate of usage and assuming adequate maintenance

(b) in all cases, the potential technical life of the asset, that is, the period of time over which the asset can be expected to remain efficient having regard to technical obsolescence

(c) in all cases, the expected commercial life of the asset, corresponding to the commercial life of its product or output (the possibility of an alternative use for the asset by the entity needs to be kept in mind)

(d) in the case of certain rights and entitlements, the legal life of the asset, that is, the period of time during which the right or entitlement exists.

5.5.9 The bases for allocating the depreciable amount ought to be appropriate to the nature of the respective assets and their expected use. The basis chosen is that which best reflects the underlying physical, technical, commercial and, where appropriate, legal facts.

5.5.10 The useful life of an asset would normally be the shortest of the alternatives applicable. These alternatives relate to an asset's expected useful life to the entity, which may be different from its useful life to another entity. An addition or modification to an existing asset may, on occasions, extend the useful life of that asset.

Opportunities for the renewal or extension of a right or entitlement are also a factor to be taken into account.

5.5.11 Where the useful life is estimated on a time basis, seve ral methods are available for allocating the depreciable amount, according to whether it is considered that the pattern of the exhaustion of the asset's service potential will remain constant from reporting period to reporting period, or will increase or decrease over time. The straight-line method is a means of determining systematic allocations which are constant from reporting period to reporting period and is most commonly adopted because of its simplicity. The reducing-balance method is one of several methods yielding allocations which decrease from reporting period to reporting period. Such decreasing allocations would be justified where an asset can be expected to yield more service in the earlier reporting periods than in the later, so that it could be argued that the earlier reporting periods ought to bear a larger allocation of the depreciable amount of the asset.

5.5.12 An alternative basis for determining the useful life of an asset is the overall output or service which the asset is expected to yield to the entity, for example, estimated production units, operating hours or distance travelled. This alternative basis is also a means of determining systematic allocations of the depreciable amount. It is appropriate in situations where the service potential of an asset can be expected to be extinguished in direct proportion to its utilisation, and before the asset becomes technically or commercially obsolete. Where the estimated useful life is assessed in terms of expected output or service, allocations will be based on the actual output or service quantities in each reporting period and hence are likely to vary from reporting period to reporting period. A variant suitable for certain specialised plant or equipment is to base allocations on measurement of the specific wear that has occurred in each reporting period through use of the asset.

5.5.13 The bases for allocating the depreciable amount need to be selected with proper regard for the underlying facts. Whichever basis is selected, it is essential that it be applied consistently, from reporting period to reporting period, irrespective of:

(a) the result/profit or loss for any one reporting period; or

(b) the amount that may be claimed as an allowable deduction when computing taxable income for any one reporting period; or

(c) whether any of the assets have been revalued.

Revaluation of Depreciable Assets

5.5.14 In relation to depreciable assets, entities can depart from the historical cost basis of accounting by periodically revaluing some or all of those assets, with a consequential adjustment of the amounts at which they are carried in the statement of financial position. Because of inflation, most revaluations result in an upward adjustment, the amount of which may be described as a "revaluation increment". The amount of a downward adjustment may be described correspondingly as a "revaluation decrement".

5.5.15 When a depreciable asset has been revalued, and the revalued amount recognised, the revalued depreciable amount is allocated on a systematic basis over the asset's useful life.

Residual Values

5.6 Where a non-current asset is not revalued, the residual value must not subsequently be increased for changes in prices. Where a non-current asset is revalued, a new estimate of residual value must be made at the date of the revaluation.

5.6.1 The estimate of residual value is based on the net amount to be recovered for similar assets which have reached the end of their useful lives and which have operated under conditions similar to those in which the asset will be used. In general, when a non-current asset is not revalued, the estimate of residual value is expressed in terms of the amount expected as at the date of acquisition and not some future value which would take into account the effect of inflation on asset prices. Residual values may still be decreased or increased for reasons other than changes in prices. For example, the residual value may need to be reduced where it becomes evident that the carrying amount of an asset is above its recoverable amount. Also, the residual value may need to be increased where there is a reduction in the estimated useful life of an asset to an entity because the entity decides it will dispose of the asset earlier than originally planned.

Subsequent Costs

5.7 Costs incurred relating to a non-current asset subsequent to it having been first put into use or held ready for use must be added to the carrying amount of the asset when and only when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the asset, will flow to the entity in future reporting periods. All other such

costs must be recognised as an expense in the reporting period in which they are incurred.

5.7.1 Subsequent expenditure on non-current assets is only recognised as part of an asset when the expenditure improves the condition of the asset beyond its originally assessed standard of performance or capacity. Examples of improvements which result in increased future economic benefits include:

(a) modification of an item of plant to extend its useful life, including an increase in its capacity

(b) upgrading machine parts to achieve an improvement in the quality of output

(c) adoption of new production processes enabling a reduction in previous operating costs.

5.7.2 Expenditure that adds future economic benefits in excess of the originally assessed standard of performance improves an asset's usefulness. For example, an item of plant that is originally assessed to have a life of 10,000 hours of operating time is operated for 3,000 hours over a year. The plant then undergoes a major overhaul that adds a further 2,000 hours operating time to its life. After the overhaul, such an item of plant can be viewed as having a total life of 12,000 hours, which is an improvement on the originally assessed 10,000 hours, and the relevant expenditure is capitalised.

5.7.3 Major components of some non-current assets may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. The components are accounted for as separate assets, and are depreciated separately, because they have useful lives different from those of the non-current assets to which they relate.

5.7.4 There may be circumstances in which the different components of service potential in an asset, which have different useful lives, are not readily identifiable. For example, a shipping channel that has a very long life may be designed with extra depth so that it needs to be dredged only once every five years. In this example, the shipping channel is considered to have two components. One component is the channel to its normal depth which is depreciated over its very long life. The second component is the extra channel depth where the expenditure incurred in creating the extra channel depth meets the recognition criteria in paragraph 4.1 and is depreciated over its five-year life.

5.7.5 The replacement of components of an asset can be distinguished from expenditure on repairs or maintenance made to help maintain the future economic benefits that an entity can expect from an asset. Such expenditure is recognised as an expense when it does not increase the level of economic benefits that will flow to the entity in future periods. For example, the cost of rectifying a breakdown of an item of plant and equipment is treated as an expense.

6 Monitoring Depreciation Rates and Methods

Regular Review of Depreciation Rates and Methods

6.1 Depreciation rates must be reviewed at least annually and, if necessary, adjusted so that they will reflect the most recent assessments of the *useful lives* of the respective *assets*, having regard to such factors as asset usage and the rate of technical and commercial obsolescence.

6.2 Depreciation methods must be reviewed at least annually and, if there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied must be changed to reflect the changed pattern.

Changes to Depreciation Rates and Methods

6.3 When depreciation rates or depreciation methods are changed, the change must be accounted for as a change in accounting estimate. The effect must be *recognised* in the reporting period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both. Depreciation recognised in prior reporting periods must not be changed either by an adjustment via the profit and loss or other operating statement or via retained profits (surplus) or accumulated losses (deficiency).

6.3.1 Being a function of factors which cannot be determined with certainty, *depreciation expenses* necessarily contain an element of approximation. This emphasises the need to review those factors at least annually with adjustment, where necessary, to existing depreciation rates or methods.

6.3.2 The following examples illustrate the approach required by paragraph 6.3. The non-conforming approach is not permitted.

Example 1

Asset cost = $60
Original estimate of useful life = 6 years
Written down cost at end of year 2 = $40
At the end of year 2, the useful life is re-estimated downwards to 5 years, leaving only 3 years of useful life instead of 4 years. The straight-line method of depreciation is used.

	Required	Non-conforming
3rd year depreciation	13.3	16
4th year depreciation	13.3	12
5th year depreciation	13.3	12

Example 2

Asset cost = $60
Original estimate of useful life = 6 years
Written down cost at end of year 2 = $40
At the end of year 2, the useful life is re-estimated upwards to 10 years, leaving 8 years of useful life instead of 4 years. The straight-line method of depreciation is used.

	Required	Non-conforming
3rd year depreciation	5	(2)*
4th year depreciation	5	6
5th year depreciation	5	6
6th year depreciation	5	6
7th year depreciation	5	6
8th year depreciation	5	6
9th year depreciation	5	6
10th year depreciation	5	6

* The ($2) depreciation charge to current profit or loss is made up of a backlog adjustment of prior-period depreciation of ($8) and a current period depreciation expense of $6.

7 Spares for Plant and Equipment

7.1 Spares purchased specifically for a particular *asset*, or class of assets, and which would become redundant if that asset or class was retired or use of that asset or class was discontinued, must be considered to form part of the historical cost of that asset or class. The *depreciable amount* of such spares must be allocated over the *useful life* of the asset or class.

7.1.1 Spares that can be used only in connection with a particular *non-current asset* do not have useful lives of their own. They are depreciated over the useful life of the related asset.

7.1.2 Spares can be distinguished from stores and supplies, which would generally be consumed on an ongoing basis and are dealt with in Australian Accounting Standard AAS 2 "Measurement and Presentation of Inventories in the Context of the Historical Cost System". Spares can also be distinguished from separate components of an asset that have their own useful lives and are discussed at paragraphs 5.7.3 and 5.7.4 of this Standard.

8 Buildings

8.1 For the purposes of determining the *depreciable amount*, the historical cost of freehold land and buildings, or other revalued amount substituted for historical cost, must be apportioned between the land and the building(s) erected on the land.

8.1.1 The limited long-term service potential of buildings is well recognised and is demonstrated in a practical manner by the continual demolition of existing buildings – residential, commercial, industrial, institutional – to make room for new buildings of usually increased capacity and of different design, providing facilities not found in the structures they replace. Buildings (as distinct from the land on which they stand) are therefore classified as physical *assets* having a limited *useful life*, and thus need to be depreciated in the same way as, for instance, plant and equipment.

8.1.2 Land is a commodity of limited supply and the increasing demand for it, particularly in urban and resort areas, strongly affects its value. Taking into consideration, on the one hand, the physical and legal nexus that exists between a piece of land and the buildings erected on it and, on the other hand, the tendency for land values to increase, some argue against requiring the depreciation of buildings on the grounds that any decline in the service potential of a building is likely to be offset by an increase in the value of the land itself. Such an argument confuses two quite distinct and separate issues. The fact that buildings have limited useful lives is a reality which needs to be *recognised* in the accounting process.

9 Leasehold Improvements

9.1 The *depreciable amount* of improvements to or on a leasehold property must be progressively allocated over the unexpired period of the lease or the *useful lives* of the improvements, whichever is the shorter.

10 Retirement or Disposal of Depreciable Assets

10.1 When a *depreciable asset* is retired or disposed of, the difference between its *accumulated depreciation* and its historical cost, or other revalued amount substituted for historical cost, less any net amount recovered on disposal, must be *recognised* as a *revenue* or an *expense*.

10.2 A depreciable asset must cease to be recognised on its disposal or when the *asset* is permanently withdrawn from use and there are no probable future economic benefits from its disposal.

11 Disclosures Relating to Depreciation

11.1 In the statement of financial position, *accumulated depreciation* must be presented as a deduction from the *asset* or class of assets to which it relates.

11.2 The following information must be disclosed, for each class of *depreciable asset*:

(a) the depreciation methods used

(b) the useful lives or the depreciation rates used

(c) the aggregate amount of depreciation allocated, whether *recognised* as an *expense* or as part of the carrying amounts of other assets during the reporting period

(d) the gross amount of depreciable assets and the related accumulated depreciation.

11.3 Where the *depreciation expenses* for any reporting period have changed because of:

(a) reassessment of the *useful lives* of certain assets; or

(b) changes in *depreciable amounts* in consequence of a revaluation (upward or downward) of certain assets; or

(c) changes in depreciable amounts following a reappraisal of the net amounts expected to be recovered on disposal of certain assets;

the financial effect of the change (that is, the increase or reduction in the depreciation expenses) must be disclosed.

11.4 Where there is a change in a depreciation method from that applied in the preceding reporting period which has a material effect in the current reporting period or is expected to have a material effect in a subsequent reporting period, the following information must be disclosed:

(a) the nature of the change

(b) the reasons for the change

(c) where the change materially affects the current reporting period, the financial effects of the change since the beginning of the reporting period, and since the date of the change in depreciation method, if the two dates differ

(d) where the change does not materially affect the current reporting period and is expected to materially affect a subsequent reporting period, a statement that the change does not materially affect the current reporting period.

12 Comparative Information

12.1 Information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period must be disclosed, except where, in respect of the reporting period to which this Standard is first applied, the superseded Standard did not require corresponding information.

13 Transitional Provisions

Initial Application of this Standard

13.1 Where the superseded Standard did not apply to the *entity* and accounting policies required by this Standard are not already being applied as at the beginning of the reporting period to which this Standard is first applied, they must be applied as at that date. Where this gives rise to initial adjustments, the net amount of these adjustments, including any adjustments to deferred income tax balances, must, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

13.2 The *useful life* of each *non-current asset* must be taken to run from the date of its acquisition and depreciation rates must be determined accordingly.

14 Definitions

14.1 In this Standard:

***accumulated depreciation* means the aggregate, at a given point of time, of the *depreciation expenses* made in respect of a particular *depreciable asset* or class of depreciable assets**

***assets* are future economic benefits controlled by the *entity* as a result of past transactions or other past events**

***current assets* means cash or other assets of the entity that would in the ordinary course of operations of the entity be consumed or converted into cash within twelve months after the end of the last reporting period of the entity**

depreciable amount* means the historical cost of a depreciable asset, or other revalued amount substituted for historical cost, in the financial report, less in either case the net amount expected to be recovered on disposal of the asset at the end of its *useful life

***depreciable asset* means a *non-current asset* having a limited useful life**

depreciation expense **means an** ***expense recognised*** **systematically for the purpose of allocating the depreciable amount of a depreciable asset over its useful life**

economic entity **means a group of entities comprising the** ***parent entity*** **and each of its** ***subsidiaries***

entity **means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

equity **is the residual interest in the assets of the entity after deduction of its** ***liabilities***

expenses **are consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period**

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

investment properties **means interests in land or buildings held by an entity for the accretion of wealth by way of** ***revenue,*** **such as rentals and capital appreciation, that are not occupied substantially for use by, or in the operations of, the investing entity, or any entities within an economic entity to which that entity belongs**

liabilities **are the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

non-current assets **means all assets other than current assets**

parent entity **means an entity which controls another entity**

recognised **means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position**

(whether or not further disclosure of the item is made in notes)

***reporting entity* means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

***revenues* are inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period**

***subsidiary* means an entity which is controlled by a parent entity**

***useful life* means:**

(a) the estimated period of time over which the future economic benefits embodied in a depreciable asset are expected to be consumed by the entity; or

(b) the estimated total service, expressed in terms of production or similar units, that is expected to be obtained from the asset by the entity.

Depreciable Amount

14.1.1 In assessing the net amount to be recovered upon the disposal of a depreciable asset, the estimate is based on the residual value prevailing at the date of the estimate for similar assets which have reached the end of their useful lives and which have operated under conditions similar to those for which the asset will be used by the entity.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 4 "Depreciation Accounting" and with International Accounting Standard IAS 16 "Property, Plant and Equipment" to the extent that IAS 16 addresses the recognition and depreciation of physical non-current assets which are expected to be used during more than one period.

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure compliance with Statement of Standard Accounting Practice SSAP 3 "Accounting for Depreciation" and with Statement of Standard Accounting Practice SSAP 28 "Accounting for Fixed Assets" to the extent that SSAP 28 addresses the depreciation of physical non-current assets which are expected to be used during more than one period.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1 The reissue of this Standard is part of a program being undertaken by the Public Sector Accounting Standards Board (PSASB) of the Australian Accounting Research Foundation and by the Australian Accounting Standards Board (AASB) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee (IASC).

2 The issue of the Standard follows consideration of the responses received on Exposure Draft ED 74 "Depreciation of Non-Current Assets", which was prepared by the AASB and the PSASB and released in January 1997. ED 74 contained proposals aimed at harmonising this Standard with International Accounting Standards IAS 4 "Depreciation Accounting" and IAS 16 "Property, Plant and Equipment".

Principal Features of ED 74 Included in the Revised Standard

3 As a result of ED 74, the Standard requires:

(a) recognition of assets with physical substance expected to be used during more than one reporting period when and only when it is probable that the future economic benefits embodied in them will eventuate and they possess a cost or other value that can be measured reliably

(b) that a depreciation method for an asset reflects the pattern in which an asset's future economic benefits are consumed or lost

(c) that, in estimating the useful life of a depreciable asset, consideration be given to expected wear and tear, obsolescence and legal or other limits on the asset's use

(d) that, where a non-current asset is not revalued, the residual value be estimated at the date of acquisition and not subsequently increased for changes in prices

(e) subsequent costs to be added to the carrying amount of an asset when and only when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the asset, will flow to the entity in future periods, with all other such costs being recognised as an expense when incurred

(f) the review of depreciation methods at least annually and, where there has been a change in the expected pattern of consumption or loss of future economic benefits, a suitably revised method of allocation

(g) that, when depreciation rates or methods are adjusted, the effect be recognised in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both

(h) that a depreciable asset cease to be recognised on its disposal or when it is permanently withdrawn and there are no probable future economic benefits from its disposal

(i) disclosure, for each class of asset, of:

    (i) the depreciation methods used

    (ii) the useful lives or depreciation rates used

    (iii) the aggregate amount of depreciation recognised, whether as an expense or added to the carrying amounts of other assets during the reporting period

    (iv) the gross amount of depreciable assets and the related accumulated depreciation

(j) disclosures relating to a change in depreciation method as if such a change were a change in accounting policy.

Noteworthy Differences from ED 74

4 Respondents to ED 74 expressed concerns about the extent of the proposal to require recognition of all non-current assets when it is probable that the future economic benefits embodied in the asset will eventuate and the asset possesses a cost or other value that can be measured reliably. In particular, respondents were concerned about mandating the recognition of so-called intangible assets, which are being dealt with in another project. The requirement in the revised Standard has been narrowed to cover the recognition of

assets with physical substance which are expected to be used during more than one reporting period.

5 The Boards also clarified the proposed prohibition on increasing residual values subsequent to acquisition for assets accounted for on a cost basis. The revised Standard makes it clear that increases in residual values as a result of changes in prices are not permitted. Commentary explains that residual values may still need to be increased for other reasons, for example, where there is a reduction in the estimated useful life of an asset and the entity decides it will dispose of the asset earlier than originally planned. Commentary also explains that residual values may need to be reduced where it becomes evident that the carrying amount of an asset is above its recoverable amount.

6 Since 1989, investment properties have been exempted from the requirements of the Standard. Subsequent to the issue of ED 74, the Boards noted that the wording of the definition of "investment properties" in the existing Standard differed from the wording in IAS 25 "Accounting for Investments". Whilst the Boards consider that the former Australian and existing IAS 25 definitions have the same meaning, in the interests of harmonisation, the Boards decided to change the Australian definition to the IAS 25 wording.