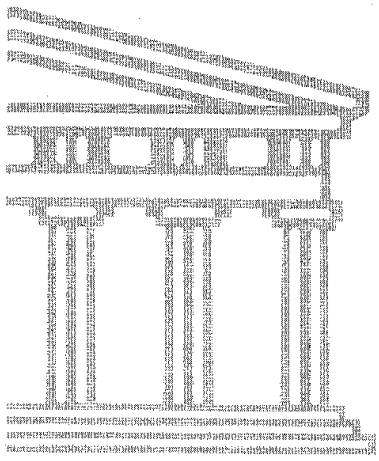
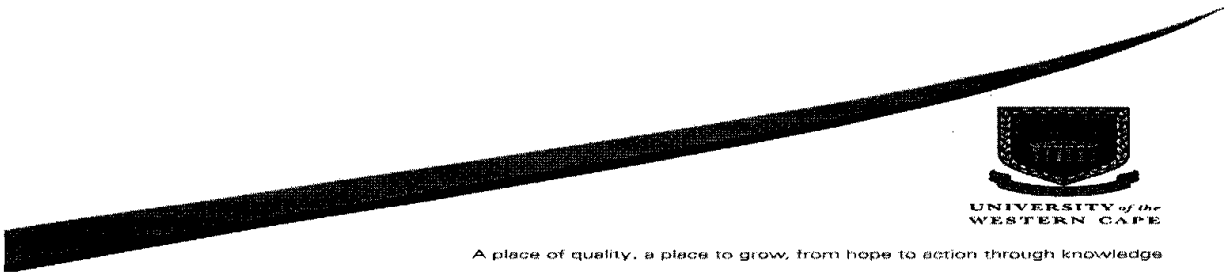


# UNIVERSITY OF WESTERN CAPE (UWC)

## POLICY
## ON PROPERTY, PLANT AND EQUIPMENT (PPE)

DATE OF LAST APPROVAL: C 2007/2



# Policy: Property, Plant and Equipment (PPE)

June 2007

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WESTERN CAPE

# Contents

# 1 Introduction

UWC was required to adopt changes to their accounting policies for the year ended 31 December 2005 as a result of the amendments and revisions to SA GAAP.

A project to address the application of IAS I6 on Property, Plant and Equipment (PPE) was initiated. The following aspects of IAS 16 were addressed in respect of each category of PPE:

- Component approach
- Remaining estimated useful Iives
- Residual values

The PPE policy outlined below has been structured to be consistent with the guidelines issued by the Department of Education, whilst at the same time complying with International Financial Reporting Standards (IFRS).

# 2 General

## 2.1 Recognition

The cost of an item of PPE shall according to !AS 16 on Property, Plant and Equipment be recognised as an asset if, and only if:

- It is probable that future economic benefits associated with the item will flow to the entity and
- The cost of the item can be measured reliably.

Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. Major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period.

## 2.2 Materiality

Materiality is not defined in !AS 16 on Property, Plant and Equipment, but materiality is defined in !AS 8 (Accounting Policies, Changes In Accounting Estimates And Errors) as:

*"Items are material if they could individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination o,f both, could be the determining.factor."*

Materiality will therefore per definition vary from organisation to organisation.

## 2.3 Capitalisation threshold

### 2.3.1 General

Per definitions all items acquired by an organisation which comply with the recognition criteria listed above should be capitalised. The Department of Education issued a guideline authorizing Universities to expense individual items with a cost of less than R5 000. The external auditors ofUWC expressed concern that this may result in the misstatement of the University's financial affairs at the reporting dates. Management conducted an analysis to determine the impact of different capitalisation thresholds on the results of the University.

### 2.3.2 Materiality

It is, however, common practice amongst organisations to apply a capitalisation threshold based on organisation specific materiality levels to ensure that the non-capitalisation of items will not result in a material misstatement of the results of that specific organisation, whilst at the same time ensuring that the PPE Registers remain manageable documents. In determining a

capitalisation threshold to be applied by UWC it follows that what may be material in one year, may not be material in a following year and vice versa.

### 2.3.3 Annual revision of threshold

The capitalisation threshold applied by UWC will be reviewed on an annual basis at the same time when the residual values and the remaining estimated useful lives of items of PPE are reviewed. The appropriateness of the set capitalisation threshold from a materiality point of *view* will thus be reassessed on an annual basis.

### 2.3.4 Exemptions

Certain items per management's discretion may be capitalised even if the individual cost of such an item is below the capitalisation threshold. Television sets may as example be capitalised regardless of the cost thereof as the SABC may insist on a list of television sets owned by the University to verify that the appropriate annual license fees are paid.

## 2.4 Initial measurement

The accounting policy of the University is to measure PPE using the cost model. The cost of an item of PPE is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the *period* of credit if significant.

## 2.5 Subsequent costs

The day-to-day servicing cost of an *item* of PPE is not recognised in the carrying amount of that item of PPE, but is expensed when incurred. These expenses are normally regarded to be of a **"repairs and maintenance" nature.**

Part of some items of property, plant and equipment may reqmre replacement at regular intervals. An entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if:

- It is probable that future economic benefits associated with the item will flow to the entity and

- The cost of the item can be measured reliably.

The cost and related accumulated depreciation of the component that is replaced should be derecognised. This will prevent the overstatement of both the cost and accumulated depreciation for financial statement purposes. Similarly, major refurbislunent costs may also require the derecognition of certain components and the capitalisation of the cost of the new/ refurbished components.

## 2.6 Depreciation (Component approach)

According to !AS 16 on Property, Plant and Equipment each part of an item of PPE with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Significant parts with similar useful lives and depreciation methods may be grouped in determining the depreciation charge.

The component approach and whether it should be applied to a specific category of PPE is discussed in more detail below. Management was of the view that the component approach only needs to be applied in respect of buildings as the other categories of PPE do not warrant any further componentisation.

## 2.7 Estimated useful life and residual values

### 2.7.1 Estimated useful life

In the case ofUWC the estimated (standard) useful life for a PPE item is the period of time over which the asset is expected to be available for use by the University.

### 2.7.2 Residual value

The residual value of an asset is defined as the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

*Example:*

A PPE item, *with* an expected useful life of 5 years, is purchased by the University on I January 2005 at a cost of R 150 000. If the University was to dispose, on 1 January 2005, of a similar PPE item which had already been used for 5 years an amount of R 20 000 would be realised. The original cost of this PPE item was **R** 120 000 and hence its current residual value is 16.67% of the original cost. The residual value of the new PPE item acquired on 1 January 2005 is therefore R 25 000 (R 150 000 x 16.67%).

### 2.7.3 Annual assessment

As per !AS 16:51 "the residual value and the useful life of an asset shall be reviewed at least at each financial year end and if expectations differ from previous estimates, the changes shall be **accounted for as a change in an accounting estimate in accordance with IAS 8** ***Accounting*** *Policies, Changes in Accounting Estimates and Errors."*

### 2.7.4 Retrospective and prospective application

With the first time application of the revised IAS l 6(AC 123) for the year ended 31 December 2005, UWC was required to determine whether the estimates applied under

AC123 were reviewed in terms of the statement and where this was not the case, the adjustments were processed retrospectively. Any subsequent changes in the estimated useful life and residual values will be adjusted prospectively in terms ofIAS 16:51.

## 2.8 Impairment

An impairment test is only required when there is an indication that an asset may be impaired.

If there is an indication of impairment the recoverable amount of the individual asset should be estimated. If it is not possible, the recoverable amount of the cash generating unit to which the asset belongs is determined. It is not likely that certain PPE items wiII generate revenues independently from other assets and as such the University in its totality is regarded as the smallest cash generating unit to which items of PPE belong.

# 3 Buildings

## 3.1 Pre IAS 16 position

Buildings were recorded at cost less accumulated depreciation. Buildings were depreciated, to a residual value of zero, on a straight line basis over an expected useful life of 50 years.

## 3.2 Measurement of cost

UWC will be a first time adopter of IFRS for the year ended 31 December 2006. UWC has opted not to elect the terms of IFRS 1:16 which states that "An entity may elect to measure an item of property, plant and equipment at the date of transition to IFRS at it's fair value and use that fair value as its deemed cost at that date. UWC has opted to continue in electing the cost model in terms of!AS 16.

It should be noted that the cost under IAS 16 that should be used is historical cost and not current replacement costs. The application of IAS 16 does not change the historical cost of an asset.

With regard to Land, IAS 16:58 states: "Land and Buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated". UWC's current accounting policy is aligned to the above in that land is accounted for separately and is not depreciated.

## 3.3 Components

Per !AS 16:44 "an entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part." Upon examination of the PPE register and through discussions with management and staff it was considered appropriate to divide buildings into component parts.

The results of the analysis conducted by the University confirmed that a number of the components identified were not significant in relation to the total cost of the building on the PPE Register.

A pragmatic approach was explored, which included assigning all buildings to a single catego,y which has similar components. In following this approach, common components were identified which together will be significant.

The categories and components can be summarised as follows:

| Type of building | Components |
|---|---|
| Lecture theatres | • Seating and fittings<br>• AirMconditioning systems<br>• Lifts<br>• rest of the building structure |
| Academic buildings with possible identifiable components | • AirMconditioning systems ***<br>• Lifts<br>• rest of the building structure |
| Hostels and accommodation | • No significant components were identified. |
| Other buildings | • No significant components apart from the building structure were identified. |
| Other structures | • Fencing<br>• Prefab classrooms<br>• Roads and walkways |

•••=The air-conditioning systems identified as components are those systems that provide air-conditioning to entire buildings and not individually mounted units. The individually mounted units are included as equipment on the PPE Register.

## 3.4 Estimated remaining useful lives

Some buildings on UWC's PPE Register are already approximately 40 yrs old. Management will be required to assess on an annual basis as to whether the standard useful life of 50 years is realistic given the nature of these buildings and with reference to the historical trend in this regard at other universities in South Africa. Any re-assessment of the remaining estimated useful lives will be applied prospectively.

## 3.5 Residual values

Based on internal discussions and with reference to industry practice, it was acknowledged that the residual value of immovable property lies in the location /value of the land itself and not the building structure.

Furthermore, considering that it is not management's intention to sell the buildings and that management's intention is to realise the asset through its use, a conservative residual value of nil was accepted.

## 3.6 Subsequent costs

Management will assess subsequent costs incurred relating to buildings to determine as to whether the recognition criteria (i.e. future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably) have been met, in which case the subsequent expenditure will be capitalised to the original cost of the building and be written off over the remaining useful **life** of the asset.

Where the expenditure incurred is a replacement of a building component identified above, the cost and accumulated depreciation of the original component will be derecognised, whilst the cost of the replacement item will be capitalised.

# 4 Computer Equipment

## 4.1 Pre IAS 16 position

Computer equipment was depreciated over a period of three years with a residual value of nil.

## 4.2 Components

Central processing units and computer monitors/screens are recorded separately on the PPE Register. Management is of the opinion that no other significant components with varying useful lives exist and as such the component approach in respect of computer equipment will be 1imited to these two components.

## 4.3 Estimated useful life

Only a small percentage in value and number of computer equipment (for example servers) is considered to have a useful life in excess of three years. The standard estimated useful life of computer equipment, based on historical information, is hence still regarded as three years.

## 4.4 Residual value

Historically UWC has not sold computer equipment that has come to the end of its useful life. If computer equipment is disposed of, it is usually through charitable means i.e. donations to schools and the like. Old computer equipment can also be transferred to another department where it may be used to perform tasks which do not require a great deal of memory or speed (e.g. cash register in the finance department) or the old computer equipment is on occasion refurbished and connected to the University's servers as dumb terminals or is dismantled and utilised for spares.

Based on the historical utilisation it was considered reasonable to assume a zero residual value for computer equipment.

# 5 Motor Vehicles

## 5.1 Pre IAS 16 position

UWC owns a number of vehicles; these vehicles were depreciated over their useful life of four years to a residual value of zero.

## 5.2 Components

Management is of the opinion that there is no material difference between the estimated useful lives of the different components of light passenger vehicles (engine and body/ frame), bakkies and trucks below 8 tons. The number of buses owned by the University and the value thereof is regarded as immaterial and as such the application of the component approach in respect thereof was not deemed necessary. It was thus decided to regard vehicles in its totality as one component

## 5.3 Estimated useful life

Based on historical trends and industry norms a standard estimated useful life of four years for vehicles is still considered to be reasonable.

## 5.4 Residual values

The residual values for vehicles should be set as determined by market forces. An active market for second hand vehicles does exist in South Africa. The residual value of a motor vehicle, in contrast to most other moveable PPE categories, is usually significant and as such a residual value of zero is not deemed appropriate.

Residual values as determined by market forces should be set. The industry publication, Mead & McGrouther, can be used as a guide when re-assessing the residual values on an annual basis.

Based on historical trends management was of the view that residual values of 30% for motor vehicles would be appropriate. Cognisance was taken of the expectation that the "wear and tear" on vehicles owned by the University is likely to be higher than under a private use scenario.

# 6 Furniture and Equipment

## 6.1 Pre IAS 16 position

Furniture and equipment were written off on a straight line basis over a five year period, regardless of the type of furniture and equipment, to a residual value of zero.

## 6.2 Components

Furniture and equipment consist mainly of: tables, workstations, filing cabinets, fax machines, stand-alone air-conditioning systems, etc. It was not deemed necessary to break these items into components as the cost of the individual assets are usually not material and is regarded to form a complete component on its own.

## 6.3 Estimated useful life

The items on the furniture and equipment PPE Register were assigned to two broad categories, namely 'furniture and fittings' and 'equipment'. The reason for this is that a single estimated useful life could not be justified given the composition of the original category per the PPE Register. It is recommended that equipment should be written off over a period of five years as this period more closely resembles the useful life of this type of asset. Furniture and fittings were considered to have a useful life ranging between 5 - 10 years based on discussions with UWC staff and management.

## 6.4 Residual values

Historically the university has not disposed of its furniture and equipment. The amounts realised were very small in comparison to the original cost of the assets and could be considered to be negligible. Management is of the opinion that a residual value of nil is a reasonable estimate for furniture and fittings and equipment.

# 7 Intangible assets

## 7.1 General

The only intangible assets included in this policy are purchased and developed software.

## 7.2 Recognition

Purchased software should be recognised at cost, including all direct costs associated with the customisation and installation thereof. Where the probability of future benefit is uncertain beyond a year the items will be expensed.

Expenditure on internally generated software should be capitalised when these costs meet the criteria for the capitalisation of development expenditure. All of the following criteria must be met before the University can capitalise internally developed software:

- The University must be able to demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale.
- The University must have the intention to complete the intangible asset and use or sell it
- The University must have the ability to use or sell the intangible asset;
- The University must be able to demonstrate how the intangible asset will generate probable future economic benefits. The University should therefore be able to demonstrate the usefulness of the intangible asset if it is to be used internally or be able to demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself.
- The University must be able to demonstrate the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- The University must have the ability to measure reliably the expenditure attributable to the intangible asset during its development.

## 7.3 Component approach

Component accounting was not deemed necessary due to the nature of purchased and developed software. The reasons for this decision are:

- There are no significant components which can be separately identified and have significantly different useful lives;
- Software functions as one item.

## 7.4 Estimated useful life

The initial estimated useful life will be determined by the expected manner and duration of its **use.**

Computer software packages will be depreciated over a period of 3 years. At each financial year-end, the useful life per software package should be re-assessed to determine if the software will still be used during the remaining estimated useful life as originally estimated or for a longer or shorter period. Any adjustment to the remaining estimated useful life will be applied prospectively.

## 7.5 Residual values

Due to the nature of software and the customisation that takes place it is very seldom that software is "saleable" at the end of its useful life. Residual values of R nil will therefore be assigned to software. Any change to residual values will be applied prospectively.

## 7.6 Software upgrades

If an upgrade meets the criteria for capitalisation (future economic benefits are expected to flow to the organisation and the cost can be measured reliably) the upgrade costs can be capitalised and be amortised over its expected useful life.

The University should consider whether the upgrade or new module is capable of being used on a stand-alone basis once the remaining software package reaches the end of its useful life. If the answer is in the affirmative the upgrade or new module is amortised over its own expected useful life. However, if it is only capable of being used over the remaining useful life of the existing software package, it is amortised over that period.

Further, consideration must also be given to whether the upgrade would extend the useful life of the original software which is being upgraded. The useful life of the upgrade and the original software that has been upgraded must then be assessed on an annual basis.

Upgrades that do not improve the current system or provide additional functionalities must be expensed when incurred, i.e. costs in order to continue with business as usual (before the upgrade) should be expensed.

## 7.7 Ongoing maintenance and IT support

Expenditure relating to ongoing maintenance (which is not expected to improve the functionality of the software), IT support and customisation should be expensed in the income statement as and when incurred.

## 7.8 Impairment

An impairment test is only required when there is an indication that an intangible asset may be impaired.

If there is an indication of impairment the recoverable amount of the individual intangible asset should be estimated. If it is not possible, the recoverable amount of the cash generating unit to which the intangible asset belongs is determined. It is not likely that intangible assets will generate revenues independently from other assets and as such the University in its totality is regarded as the smallest cash generating unit to which intangible assets belong.

## 7.9 Derecognition

Computer software should be derecognized when it is disposed of or when no future economic benefits are expected from its use or disposal.