FIXED ASSETS & DEPRECIATION

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Both accountants and business people are grappling with the controversial accounting term known as depreciation. When financial statements are prepared the depreciation figure can be confusing. It can be too high at times, or too low, or just not properly done at times.

What is depreciation?

It is the accounting term used to describe the wear and tear of assets over a certain period of time. Depreciation is written-off against the income statement, based on a certain rate, and reduces assets on the balance sheet. Since it affects the bottom line, profits, it should be reasonable and fair. When profits on the disposal of assets are measured, the depreciation rate can affect that profit as well.

To derive maximum benefit from the business assets, the services of experts have to be considered. Depreciation percentages are easy to grasp, but it is with the implementation where businesses can encounter many problems.

Be selective with the accountant that will deal with your assets and taxes.

The accountant or tax consultant, should not only be conversant with the basic bookkeeping entries, but also with the fixed assets register, as well as complex developments in International Financial reporting Standards and changes in tax laws.

Mistakes and neglect with the fixed assets of a business's can result in losses running into thousands.

In as much as the services of outsiders are encouraged, there is just no getting away from the fact, that the business owner should become more hands on in the management of the businesses assets.

An expert can help, but he/she is not on your premises on a daily basis.

Since fixed assets, create economic benefits, the management and utilisation of your assets to derive further economic benefits, in these precarious economic times, cannot be overlooked. Also take note of the provisions that propose depreciation on buildings. Land however appreciates, and rarely depreciates.

With the changes in International Financial Reporting Standards, radical changes from these bodies have been proposed. Useful life and economic life, in depreciation, is not necessarily the same thing. We furthermore have to look at prescribed statutory tax rates, which differ vastly from normal depreciation rate, and how that would affect the bottom line in a business.

No transaction for depreciation will pass through your physical books. The depreciation amount will be based on prescribed guidelines to determine the amount. The entry is based on no source document, and is known as a "book entry. What makes depreciation more contentious is the fact that it is a book entry. So even if the books are neatly prepared and balanced, the "depreciation factor", leaves room for manipulation. Tampering with the depreciation rate/amount can result in either a loss or profit depending on the circumstances.

Even if strict International Financial Reporting Standards (IFRS) guidelines are followed, the carrying values and residual values can be tampered with.

A reasonable estimate could be 25% on machinery, but what if the machine is used for more than four years? Or alternatively, a computer can be used for 1 year whilst a depreciation rate of three years was provided for.

The following points are crucial for depreciation:

- Depreciate on a systematic basis
- Review depreciation methods annually
- Review residual values and useful lives annually.

Apart from IFRS, guidelines, the business should have clarity of the exact amount of years the asset will be used for.

Before calculating depreciation figures, thorough research should be performed on the fixed assets, its true values, residual values, useful life and economic life. Since these concepts are vital when final calculations are performed.