PROVINCE OF KWAZULU-NATAL

POLICY ON CALCULATION OF DEPRECIATION FOR STATE-OWNED VEHICLES AND SETTING OF RESERVE PRICES FOR BOS VEHICLES TO BE SOLD ON PUBLIC AUCTION

1. BACKGROUND

1.1 The Public Finance Management Act, 1 of 1999 section 38 (1) makes provision for the Accounting Officer for a department, entity or constitutional institution to be held:

- responsible for the effective, efficient, economical and transparent use of the resources of the department; and
- responsible for the management, including the safeguarding and maintenance of the assets, and for the management of the liabilities of the department, trading entity or constitutional institution."

1.2 Furthermore, in terms of section 10.1.2 of the Treasury Regulations to the PFMA, "the Accounting Officer must ensure that processes (whether manual or electronic) and procedures are in place for the effective, efficient, economical and transparent use of the institution's assets."

1.3 Depreciation of assets is a process which is no exception to the above, and therefore an appropriate method of calculating the depreciation of assets must be in place. This is especially vital when movable assets, for e.g. motor vehicles are disposed off after their useful life. The amount realized from the disposal thereof must be compared against the depreciated amount of the vehicle in order to determine whether a loss or income has been realised and for such to accordingly be debited or credited in the respective Departments' books.

1.4 In view of the above considerations, it is therefore necessary to implement an appropriate method of calculating depreciation of motor vehicles for accounting purposes. Furthermore, in terms of the disclosure requirements in the Asset Management Framework, the following should be disclosed for each major class of depreciable asset:

- The depreciation methods used and the valuation bases used for determining the amounts at which depreciable assets are stated should be included in the disclosure of accounting policies
- Total depreciation charged to income
- Total accumulated depreciation provided for the period
- The gross amount of depreciable assets and the related accumulated depreciation.

1.5 The depreciated values of the Provincial fleet of KwaZulu-Natal are currently determined by using the Auto Dealers Guide published by Mead and McGrouther. Accordingly, trade and retail values are elements of the equation. The trade value includes the dealers' estimates of the cost of refurbishing a vehicle which has been purchased or traded in. The retail value is the price which that particular vehicle is anticipated to be sold for by the Auto Dealer. These values are both market related and the Auto Dealers Guide is accepted in the motor industry.

1.6 However, the use of the Auto Dealers Guide only is not a realistic method for the calculation of depreciation of government vehicles due to specific disposal and procurement rules applicable to state vehicles. State vehicles are purchased off a national vehicle procurement contract with vehicle manufacturers. The vehicles are therefore purchased at contract prices which are not market related. Further, the vehicles are not traded in to the Auto Dealers. Instead, they are disposed off by public

auction. The sale prices are therefore determined by the bidders instead of the market. It is however mentioned that as the trade value includes the cost of refurbishing the vehicle, the use of the trade value is not appropriate. To this end, the Trade-in value would be appropriate. The Trade-in value is the value that an auto dealer would be expected to pay for a particular make and model used vehicle in its present state without the cost of refurbishment included, prior to the sale of such vehicle. This would apply to official vehicles sold on public auction as these vehicles are sold "voetstoets".

1.7 In view of the fact that private persons are bidding for the vehicles including dealers, vehicles should therefore be disposed of at market related prices. Further, in terms of Treasury Instruction 10.2.1 to the PFMA "Disposal of movable assets must be at market-related value or by tender or auction, whichever is most advantageous to the State, unless determined otherwise by the relevant treasury". It is therefore imperative that vehicles are sold at the best possible prices. To this end it is necessary to set realistic, market related reserve prices for each vehicle.

1.8 Currently the setting of reserve prices for official vehicles sold on public auction are determined by technical staff based on experience and current market trends. Inasmuch as this has not detrimentally impacted on vehicles sold, it is necessary that a formal method of calculating reserve prices be documented, based on market related values. It is important to note that the calculation of depreciation will not affect the setting of reserve prices.

2. PURPOSE

The purpose of this policy is to amend the existing Depreciation Policy in determining the depreciated values of the Provincial vehicle fleet, as per Annexure A, and document a method of calculating reserve prices for KwaZulu-Natal official vehicles sold on public auction, as per Annexure B.

3. DISCUSSION – CALCULATION OF DEPRECIATION

3.1 An asset becomes obsolete after a certain number of years and therefore must be depreciated over its expected useful life. In terms of Practice Note 006 dated August 2002, depreciation is a systematic allocation of the cost of an asset or other amount substituted for its cost in the financial statements (less residual value if any) over its estimated useful life. Depreciation recognises the gradual exhaustion of the asset's service potential. The Provincial vehicle fleet is no exception to this accounting principle as the scrap values or net book values are determined when vehicles are placed on the Board of Survey (BOS). A vehicle is placed on the BOS when it has been in an accident and written off or uneconomical to run, and meets the criteria for replacement in terms of the KwaZulu-Natal Vehicle Replacement Policy. The net book value is the original cost price of the vehicle less the accumulated depreciation at that point in time. The cost price is the original purchase price including all other related expenses incurred such as delivery, etc. Therefore, the cost price remains constant through the vehicle's useful life.

3.2 There are several methods of calculating depreciation such as the i.e. straight line and diminishing balance methods.

Straight-line method: Where the cost of the asset is recognised in "equal instalments" over its expected useful life. For example: Vehicle value = R100 000 assuming 20% depreciation rate will show a depreciation charge of R20 000 each year.

Diminishing balance method: Where the cost of the asset is recognized in reducing instalments over its useful life based on the carrying amount of the asset. For example: Vehicle value = R100 000 assuming 20% depreciation rate will show a depreciation charge of R20 000 in year 1, R16 000 in year 2 etc

3.3 The Straight-line method is more appropriate for calculating depreciation for state-owned vehicles in consideration of the following factors:

- It is easy to calculate
- It is the most widely used method
- It is recommended by Practice Note 006 dated August 2002
- Vehicles would be scrapped on cost of the asset at the end of their economic lifespan, see example at Annexure A.

3.4 It can be argued that the straight line method of depreciation is not appropriate when dealing with official vehicles due to the fact that the value of the vehicle is eventually written down to zero. Cognizance must be taken of the fact that the useful life of vehicles in the Province is 4 years to be line with the Provincial Vehicle Replacement Policy, the aim of which is to ensure a young fleet.

3.5 If an official forfeits State protection and is held liable for a loss to the State, then it could occur that if the vehicle is older than 4 years (but is still in good condition) the official would not be called upon to contribute towards the actual loss suffered by the State, as it could be argued that as the vehicle is older than 4 years, it has no value. In reality however, the vehicle will have a market related value. In view hereof, the amount that the vehicle would have realized if sold on public auction should be utilised to determine a forfeiture of rights, in the event of the vehicle being written off. In other words, the reserve price set according to the formula on Annexure B. If the vehicle is to be retained in service, the actual cost of repairs should be recovered from the official.

4. DISCUSSION – SETTING OF RESERVE PRICES FOR OFFICIAL VEHICLES SOLD ON PUBLIC AUCTION

4.1 With the provisions of paragraphs 1.5 and 1.6 in mind, and the fact that the Auto Dealers Guide provides both trade and retail values of vehicles, which are market related, it is in the best interest of the State to set reserve prices based on calculations in the Auto Dealers guide. It can be argued that this is not reasonable to utilise such as the vehicles are purchased at discounted prices of the national contract. However if you consider that when an official purchases a subsidized vehicle, then he obtains the vehicle at a substantially reduced price. The official utilizes the vehicle for a period of time and then disposes of it at market related price. The fact that official vehicles are purchased at discounted prices should be of no or little consequence when setting reserve prices when vehicles are sold on public auction.

4.2 The reserve price impacts on the sale price of the vehicle which in turns determines whether the Department has incurred a loss or savings. The reserve price ensures that the vehicle was sold at the best possible price in the best interest of the State. Once the vehicle is sold, the sale price must be compared against the depreciated value of the vehicle, to determine the loss or saving. A positive figure will indicate a saving and therefore a credit in the Department's books whilst a negative figure will indicate a loss and therefore a debit in the Departments books. This loss will have to be written off by the Department's Loss Control section.

4.3 In addition to the above, serious consideration needs to be given to assessing the condition of the vehicle, taking into consideration mileage, repairs to be undertaken, whether the vehicle is a runner, etc. Technical expertise will therefore also be part of the equation when setting the reserve price. The mileage of the vehicle and the condition of the vehicle as determined by a % at the back of the Auto Dealers Guide

must either be added or subtracted to the average of the trade and retail prices. An example of the calculation is attached hereto as Annexure B.

4.4 In view of the provisions of Treasury Regulation 10.2.1 and the paragraphs above, it would appear that the utilization of the Auto Dealers Guide would be in the best interest of the State for the calculation of reserve prices.

4.5 As a further check and balance, once a reserve price has been set, amounts realised from previous sales for the same type of vehicle must be scrutinised to ensure that realistic and market related reserve prices are set. Furthermore, as mentioned previously, the sale prices are determined by the bidders which is ultra vires to the provisions of the Treasury Regulations. By utilising the method at Annexure B, this risk is eliminated.

5. RECOMMENDATIONS

In view hereof, it is recommended that:

(a) A complete and accurate record of the following information for official vehicles should be maintained and updated by all Departments:

- Date of acquisition
- Purchase price
- Expected useful life
- % depreciation
- Registration number
- Engine number
- Chassis number
- Year, make and model
- Owner and location of vehicle
- Reserve Price
- Sale price

(b) The straight-line balance method as per attached formulae on Annexure A should be applied to calculate the depreciation of the Provincial vehicle fleet.

(c) The useful life of the abovementioned category vehicles should be 4 years, in line with the Provincial Vehicle Replacement Policy and industry norm.

(d) The cost/purchase price of sedans, minibuses, LDV's and heavy duty vehicles should be depreciated at a rate of 25% p.a. over 4 years.

(e) All Provincial vehicles should be disposed off by the relevant owner Department in a manner which is most advantageous to the State. Armoured vehicles should be disposed off by tender to companies which meet the stipulations of the National Conventional Arms Control Act.

(f) Reserve prices for official vehicles to be sold on public auction must be calculated as per the formula on Annexure B, utilizing the Auto Dealers Guide.

(g) If the vehicle has been recommended for Board of Survey at any point during it life, the depreciation expense for that year should be apportioned accordingly (i.e. on a pro-rata basis) and compared against the amount realized from the sale of the vehicle to determine whether a loss/savings has been incurred.

(h) If the vehicle is bidded for less than 90% of its reserve price, it should be withdrawn from the sale and put on hold for the next sale.

(i) Should the vehicle be carried forward to the next sale, following its failure to achieve the minimum of 90% of its reserve price, new reserve prices should be determined, accordingly.

(j) At the third attempt, the vehicle must be sold at the highest bid offered irrespective of whether 90% of the reserve price is realized.

(k) The amended policy on calculation of depreciation for Province-owned vehicles and calculation of reserve prices for official vehicles sold on public auction should be adopted and implemented in the Province of KwaZulu-Natal upon date of signature/approval by the Director-General: KZN

SUPPORTED/~~NOT SUPPORTED~~

MR BC HLABISA
HEAD: TRANSPORT

Dec 19 2007
DATE

APPROVED/~~NOT APPROVED~~

DR KB MBANJWA
DIRECTOR-GENERAL:
PROVINCE OF KWAZULU-NATAL

27/01/2008
DATE

ANNEXURE A

CALCULATION OF DEPRECIATION USING THE STRAIGHT LINE METHOD

LIGHT DUTY VEHICLES

For Light Duty Vehicle (i.e. sedans, bakkies, combi's), the cost/purchase price will be depreciated at a rate of 25% p.a. i.e. over 4 years.

EXAMPLE

A Toyota Condor was purchased at a cost of R 150 000-00 on 1 April 2002 and was brought into use on the same day.

The depreciation calculation for this vehicle will be as follows;

The annual depreciation charge will be: R150,000/4 years or R150,000 x 25% = R37,500

The annual calculation to determine the value of the vehicle over its useful life (4 years) will be as follows;

Year	Date	Detail	Amount
	1April 2002	Cost	150,000
Year 1		Less Depreciation	(37,500)
	31 March 2003	Cost of Asset (vehicle)	112,500
Year 2		Less Depreciation	(37,500)
	31 March 2004	Cost of Asset (vehicle)	75,000
Year 3		Less Depreciation	(37,500)
	31 March 2005	Cost of Asset (vehicle)	37,500
Year 4		Less Depreciation	(37,500)
	31 March 2006	Cost of Asset (vehicle)	0

At the end of year 4, this vehicle will be written down to nil.

If the vehicle were to be sold, in any year during its life, the depreciation charge for that year will be apportioned, accordingly.

ANNEXURE B

CALCULATION OF RESERVE PRICES FOR OFFICIAL VEHICLES SOLD ON PUBLIC AUCTION: PROVINCE OF KWAZULU-NATAL

Preamble

The Auto Dealers' Guide pertaining to the month in which the vehicle is to be sold must be utilised to ascertain a realistic value of a vehicle.

The value is calculated by adding the trade-in value to the retail value and dividing the two values to come up with an average. The condition and mileage of the vehicle together with any extras, which were on the vehicle, for example air conditioning are also determined and calculated in the equation. The method of how to determine this value is also contained in the Auto Dealers Guide,

Prior to calculating the reserve price, the following information must be on hand:

(a) The make and model of the vehicle, for example Mazda 323, 130 Sedan (1993) model is used as an example

(b) Registration number

(c) Engine and chassis number where available

(d) The condition of the car for excellent, very good, good, poor, or very poor.*

(e) The last odometer reading (Local Transport Officer must get last odometer readings on log books where it is impossible to physically check on the vehicle).

***In assessing the condition of the vehicle, the following must be checked by the technician/assessor:**

- DISTANCE TRAVELLED
- ENGINE
- COOLING SYSTEM
- TRANSMISSION
- CHASSIS/FRAME/INTEGRAL CONTRUCTION MEMBERS
- SUSPENSION
- STEERING
- BRAKES
- TYRES
- ELECTRICAL
- BODY
- PAINTWORK AND APPEARANCE

See next page for calculation of reserve prices

STEP I
Look for the make and model of the vehicle in the Auto Dealers Guide.

STEP 2
CALCULATE TRADE-IN VALUE

- Find – Trade value reflected as T from the top extreme right side of the page for the particular make and model of the vehicle concerned.
- To the listed Trade value of the vehicle, add the value of any optional extras fitted, in order to establish a full TRADE value for that particular vehicle
- From the Kilometre and Condition Chart on the rear flap of the Auto Dealers Guide, establish a suitable ADJUSTMENT PERCENTAGE, determined by the number of kilometres traveled and the vehicle's condition level.

  To calculate the ADJUSTMENT PERCENTAGE:

  Find the odometer reading from the kilometre chart at the back of the Auto Dealers' Guide Book and the condition of the vehicle. The odometer reading must match the condition along the same column to determine the ADJUSTMENT PERCENTAGE.

  In our example, suppose the odometer reading for Mazda 323 130 Sedan (1993) is 73 498 and the condition of the vehicle at the time of incident, was good. The closest figure on the Guide to the odometer reading of the vehicle must be used. The closest figure to 73 498 is 71 400 from the guide for example. Right down the column of 71 400 for a good condition vehicle, is +5%. The ADJUSTMENT PERCENTAGE therefore = +5%

- Multiply its full trade value by this adjustment percentage.
- Now subtract the expected refurbishment costs to arrive at an estimated Trade-in price.

NB: It is crucial that the anticipated cost of repairing the vehicle must be on hand irrespective of fact that the vehicle is not going to be repaired.

STEP 3
Find Retail value reflected as R in the same way as T.

STEP 4
Trade-in and Retail values must be added from our example. The Trade-in value as calculated in step 2 above and Retail values of a Mazda 323 130 Sedan, model 1993 must be used.

STEP 5

Divide the sum of these values by 2 to get an average.

Suppose the Trade-in and Retail values of Mazda 323 130 Sedan, 1993 are R16 500 and R19 900 respectively. Therefore, Trade-in Value (TiV) + Retail Value (RV) ÷ by 2

$$\frac{TiV + RV}{2}$$

$$\frac{16\,500 + 19\,900}{2}$$

= R18 200

STEP 6

Look at database for amounts realised from previous sales for the same type of vehicle. If the reserve price calculated above, is higher than a previous sale price, the reserve price calculated should remain. However, if the reserve price calculated above, is lower than 90% of the previous sale price, the reserve price should be adjusted accordingly (should be adjusted to the lower figure).