

## **Residual Value of Recyclable Assets**

### **AASB Staff Issues Paper**

#### **Introduction**

- 1 In June 2014, the Board received a submission<sup>1</sup> requesting the AASB clarify the definition of residual value in AASB 116 *Property, Plant and Equipment*. Specifically, whether the intention of AASB 116, through the definition of residual value, is to limit the recognition of residual values to instances in that an entity expects to obtain consideration from the sale of an asset at the end of its useful life.
- 2 The Board considered the submission in September 2014<sup>2</sup> and noted the issue:
  - (a) is not limited to the not-for-profit (NFP) sector; and
  - (b) could apply to a range of recyclable assets.
- 3 The Board directed staff to conduct targeted outreach on the issue, in both the for-profit and NFP sectors, to assess the prevalent accounting treatment for recyclable assets and whether diversity in practice exists.

#### **Objective and structure of this paper**

- 4 The objective of this paper is to provide a summary of the feedback received from the targeted outreach performed and provide options for how to progress the project.
- 5 This Agenda Paper is structured as follows:
  - (a) summary of feedback received from targeted outreach (paragraphs 6–33);
  - (b) alternatives for progressing with the project (paragraphs 34); and
  - (c) staff recommendation and questions for the Board (35–37).

#### **Summary of feedback received from targeted outreach**

- 6 Staff conducted targeted outreach, including discussions with valuation specialists, council representatives, auditors and public infrastructure experts, during September 2014 – January 2015. The issue was also raised at a number of professional body conferences and at a Melbourne ‘Emerging Financial Reporting Issues’ meeting. In addition, four submissions were received from constituents (see Agenda Paper 18.3).

#### **Diversity in practice**

- 7 Several respondents indicated that diversity in practice exists in the accounting for recyclable assets in the NFP sector. Specifically, feedback from the targeted outreach indicated that NFP entities are:

---

1 [Residual Value Submission](#) (accessed 27 January 2015)

2 [AASB Minutes M141\\_3-4\\_Sept\\_2014](#) (accessed 27 January 2015)

- (a) recognising residual values for recyclable infrastructure assets in order to reduce the depreciable amount of those assets<sup>3</sup>; or
  - (b) not recognising residual values for recyclable infrastructure assets and, therefore, depreciating the whole amount of an asset by the end of its useful life.
- 8 Staff understand that this diversity in practice is due to differing interpretations, and applications, of the definition of residual value.
- 9 Although, consistent with the Board's view in September 2014, respondents to the targeted outreach indicated that the issue is not limited to the NFP sector, no feedback was received during the targeted outreach that identified any diversity in practice for for-profit entities.
- 10 The remaining feedback summary relates to feedback received in relation to NFP entities.

### Definition of Residual Value

- 11 Respondents expressed mixed views as to whether the definition of residual value is clear, with some respondents of the view that the definition is clear, and other respondents indicating that the definition was open to interpretation.
- 12 The two predominant views expressed by respondents to the targeted outreach in respect of the definition of residual value<sup>4</sup> are as follows:
- (a) a residual value is only recognised in circumstances where an entity expects to receive consideration for an asset at the end of its useful life. That is, recognition is limited to instances in that an entity expects to relinquish control of an asset at the end of its useful life in return for consideration (**View 1**); and
  - (b) residual value encompasses the cost savings in replacing an asset. That is, recognition is *not* limited to instances in that an entity expects to relinquish control of an asset at the end of its useful life in return for consideration (**View 2**).

### *View 1*

- 13 One respondent supporting view 1 suggested that recognising residual values for recyclable assets is inappropriate and is not consistent with a literal interpretation of the definition of residual value in AASB 116. The respondent argues that an appropriate interpretation of AASB 116, in relation to the recognition of a residual value, would require proceeds from the sale of an asset at the end of its useful life.

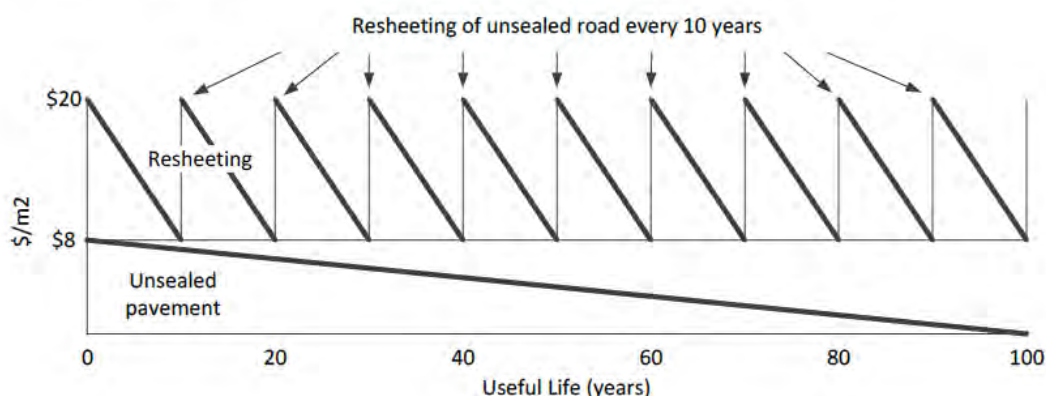
---

3 For example, one respondent noted that a review of the accounting for long-lived infrastructure assets, particularly roads, in Tasmania indicated that councils were recognising residual values in order to reduce the depreciable amount of assets, and consequently depreciation.

4 Paragraph 6 of AASB 116 defines residual value of an asset 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 were already of the age and in the condition expected at the end of its useful life.*

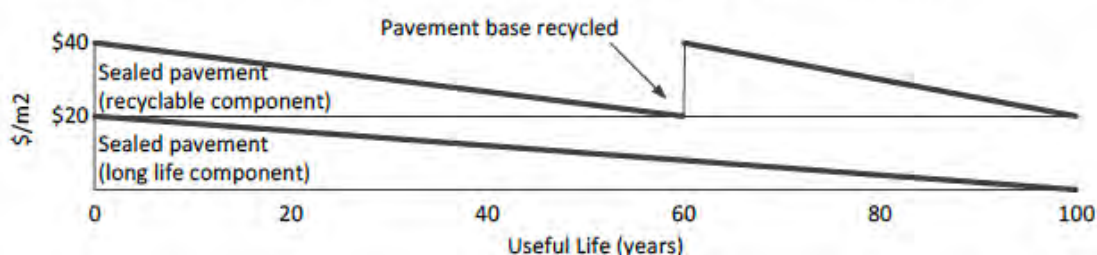
- 14 In respect of the accounting for roads subject to recycling, the respondent argues that such roads should be componentised in order to separately account for the recyclable and non-recyclable components of that road.
- 15 To illustrate this point, the respondent considers two types of roads, unsealed roads and sealed roads. In the case of un-sealed roads, consistent with the fact pattern in the original submission, the respondent argues that the appropriate accounting treatment can be achieved through componentisation of the asset.
- 16 The following extract from the respondent's submission illustrates this point:

*Figure 1: Depreciation of Unsealed Roads with Resheeting of Wearing Surface*



- 17 The respondent considers the long-life component, the unsealed pavement, is depreciated over a longer useful life than that of the resheeting component. The shorter life of the resheeting component is appropriate due to the erosion of gravel from usage and/or weather conditions. At the end of the resheeting component's useful life, new gravel (sheeting) will be added and mixed with the existing recyclable gravel (unsealed pavement).
- 18 In the case of sealed roads, the respondent considers such roads should be componentised into 'recyclable' and 'long-life' components<sup>5</sup>. In the example provided by the respondent, the cost of the recyclable component is the cost of planned recycling and stabilisation and is depreciated over a shorter useful life than that of the long-life component.
- 19 The extract from the submission illustrates the submitters argument in the case of a road subject to 'full-depth' recycling:

*Figure 3: Depreciation of Sealed Pavement to be Recycled – Option B*



5 AASB consider the long-life component is the recyclable component (as discussed in paragraph 28).

- 20 The submitter contends that the cost of the recyclable component of the sealed pavement is the ‘estimated cost of planned recycling and stabilisation’. Whereas the cost of the long-life component is the cost of construction less the estimated cost of planned recycling and stabilisation.
- 21 Consistent with the views of the respondent, the Tasmanian Auditor-General’s 2013-14 report<sup>6</sup>, co-authored by the respondent, recommends that councils should:
- (a) rely less on the use of residual values for infrastructure assets;
  - (b) practice a greater reliance on cost-based fair value assessments; and
  - (c) make greater use of componentisation for assets consisting of parts with varying estimated useful lives.

#### View 2

- 22 Some respondents expressed agreement with the original submitter and consider the definition of residual value is unduly limiting in the NFP sector (if View 1 in paragraph 12(a) above is applied).
- 23 These respondents consider the cost savings associated with recycling in-situ material in order to bring an asset back to its original condition should be considered to be the residual value of that asset. These respondents think that the view expressed in View 1 does not reflect the way in which certain assets, particularly infrastructure assets, are managed.
- 24 In the case of sealed and unsealed roads, the respondents consider the depreciable amount is the difference between the cost of an asset and the residual value of that asset, where the cost savings associated with the reuse of materials contributes to the residual value.
- 25 Respondents supporting View 2 also provided examples of infrastructure assets that they consider the residual value should encompass the cost savings from re-use of in-situ materials (see Agenda Paper 18.3).<sup>7</sup>

#### Staff analysis

- 26 Staff consider the definition of residual value in AASB 116 *does* limit its application to instances in that an entity expects to relinquish control of an asset, that is at the end of its useful life, in return for consideration. Therefore, if an entity does not expect to receive consideration for an asset at the end of its useful life, the residual value will be nil. Accordingly, staff agree with View 1.

---

6 Report of the Auditor-General No. 5 of 2013-14 *Infrastructure Financial Accounting in Local Government*. Available at: <http://www.audit.tas.gov.au/media/Report-of-the-Auditor-General-No.-5-of-2013-14-Infrastructure-Financial-Accounting-in-Local-Government.pdf> (accessed 19 January 2015).

7 Note that one respondent supporting View 1 argues that the use of residual values in these instances is inappropriate and not consistent with the requirements of AASB 116.

## Componentisation

- 27 In respect of the recycling of roads, staff consider it is appropriate to componentise (AASB 116 paragraph 13), and depreciate over different useful lives (AASB 116 paragraph 43), the recyclable and non-recyclable parts of that road.
- 28 Staff consider that in the case of the recyclable sealed road, the figure submitted by the respondent (in paragraph 19 above) might be better illustrated by considering the long-life sealed pavement as the recyclable component. This is because the short life component (the estimated cost of planned recycling and stabilisation) has no value at the end of its useful life and therefore it would be inappropriate to consider this as recyclable. In contrast, the full-depth of the long-life component is in fact being excavated, mixed with materials and stabilised to restore the road – that is, it is being recycled.

## Useful life

- 29 Paragraph 6 of AASB 116 defines the useful life of an asset as:
- (a) *the period over which an asset is expected to be available for use by an entity;*  
*or*
  - (b) *the number of production or similar units expected to be obtained from the asset by the entity*
- 30 AASB 116 does not explicitly state that consideration should be given to alternative uses for the asset when estimating its useful life. However, AASB 116 states that when determining the useful life for an asset, consideration should be given to ‘the repair and maintenance programme, and the care and maintenance of the asset while idle’ (paragraph 56(b) of AASB 116).
- 31 Further, paragraph 12 of AASB 116 requires costs of day-to-day servicing, or ‘repairs and maintenance’, to be expensed in the period they are incurred. Whereas paragraph 13 of that Standard considers the costs of replacing part of an item of property, plant and equipment should be capitalised to the carrying amount the asset. It therefore is important to distinguish those events that are ‘repairs and maintenance’ from those that are ‘replacements’ of parts.
- 32 For example, in relation to the fact pattern within the original submission, an unsealed road subject to recycling at the end of its ‘service’ life, if the useful life of the in-situ material extends beyond its service life, dependent on the nature of the intervention, the carrying amount at the time of intervention may be similar to the cost savings arising from the recycling of the gravel.<sup>8</sup> In contrast, if the useful life is limited to the service life of the road, the remnant gravel would be fully depreciated and the entity would not recognise the remaining economic benefits embodied in the asset.

---

8 Staff consider that, in such circumstances, it may be appropriate to revalue the recyclable component and/or extend its useful life in accordance with paragraphs 31 and 51 of AASB 116, respectively.

### *Staff view*

- 33 Staff consider the appropriate estimation of useful lives for components is important to accurately calculate the consumption (depreciation) of economic benefits embodied within an asset. Staff are of the view that the useful life of recyclable parts (for example, gravel) could extend beyond the service life of the larger asset (for example, the road).

### **Alternatives for progressing with the project**

- 34 In accordance with the *AASB Interpretations and Improvements Model* (June 2006, as modified in February 2012)<sup>9</sup>, and the *Process for Modifying IFRSs for PBE/NFP*<sup>10</sup>, the Board could:
- (a) take no action and give reasons (e.g. as an Agenda Decision);
  - (b) direct staff to prepare a staff article explaining the application of the definition of residual value and to provide some guidance in those areas giving rise to diversity in practice
  - (c) refer the issue to the IFRS Interpretations Committee for consideration; or
  - (d) add the issue to the work program.

### **Staff recommendation and questions for the Board**

- 35 Consistent with the Board's discussion in December 2014, staff consider that although this issue is prevalent in the not-for-profit sector, it is not not-for-profit entity specific.
- 36 Staff recommend a staff article be written explaining the application of the definition of residual value and to provide some guidance in those areas giving rise to diversity in practice. Staff think that a staff article, as an educative avenue, could assist users with some of their concerns as to the application of the definition of residual value and, accordingly, will help reduce diversity in practice.
- 37 Staff do not recommend the other alternatives for the following reasons:
- (a) take no action and give reasons (e.g. as an Agenda Decision) – feedback from the targeted outreach indicated diversity in practice that would be unlikely to be addressed through an Agenda Decision.
  - (b) refer the issue to the IFRS Interpretations Committee – while staff think the issue is not sector specific, staff consider that the issue is likely to be of limited practical relevance to the for-profit sector as in many cases the residual value will be immaterial. Accordingly, staff do not think the issue meets the criteria for referring the issue to the Committee.
  - (c) add the issue to the work program – staff do not support developing specific NFP requirements in relation to residual value as, consistent with the staff view

---

<sup>9</sup> [AASB Interpretations and Improvements Model Feb 2012](#) (accessed 19 January 2015).

<sup>10</sup> [Process for modifying IFRSs](#) (accessed 27 January 2015).

expressed in paragraph 27 above, staff think the definition of residual value is sufficiently clear as to its application. Further, although staff acknowledge the existence of diversity in practice, on balance staff do not support adding NFP specific Application Guidance to AASB 116 on the basis that the diversity could more readily be addressed via further education, rather than amendment to the Standard.

**Question 1**

- (a) Does the Board agree with the staff recommendation to write a staff article on the issue?
- (b) If not, how does the Board wish to progress the project:
  - (i) take no action and give reasons (e.g. as an Agenda Decision – refer to the Appendix of this paper for draft wording of an Agenda Decision should the Board wish to pursue this alternative);
  - (ii) refer the issue to the IFRS Interpretations Committee for consideration; or
  - (iii) add the issue to the work program.

## **Appendix – Proposed wording for AASB Agenda Decision**

### **Australian Accounting Standards Board**

### **Rejected Issue – Not Taken onto the Agenda**

### **Accounting for Recyclable Assets**

**(Month 2015)**

#### **The Issue**

The issue is the accounting for recyclable assets. Specifically, the issue relates to whether the residual value of such assets should include the cost savings from the re-use of in situ materials.

#### **Reasons for Not Adding the Issue to the AASB's Agenda**

The AASB decided the definition of residual value in AASB 116 *Property, Plant and Equipment* is clear. In order to meet the criteria for recognition, the AASB considered residual values would only be recognised when an entity expects to receive consideration for an asset at the end of its useful life. The AASB decided not to refer the issue to the IFRS Interpretations Committee as it did not meet the criteria of 'practical relevance' for for-profit entities, as set out in the *Interpretations and Improvements Model* (June 2006, as modified in February 2012).

The AASB decided the requirements in AASB 116, in respect of componentisation and depreciating separately parts of property, plant and equipment, were also clear. Accordingly, the AASB considered these requirements apply equally to not-for-profit entities when managing infrastructure assets such as roads, pipelines and roofing structures.