

Residual Value of Recyclable Assets

AASB Staff analysis of Additional Feedback from Targeted Outreach

Introduction

- 1 Staff conducted targeted outreach from September 2014 – January 2015 in relation to the accounting for recyclable assets in AASB 116 *Property, Plant and Equipment*. Agenda Paper 8.2 summarises the feedback received from constituents during that period. Subsequent to the completion of Agenda Paper 8.2, and prior to the 11 February 2015 AASB meeting, staff received further feedback from constituents. Specifically, staff liaised with the original submitter (OS) of the issue and an asset valuer (AV), who had both provided input to the discussion in Agenda Paper 8.2 (in the main, agreeing with View 2 in that paper).
- 2 The objective of this paper is to summarise the additional feedback received in relation to the issue.

Summary of further constituent feedback

Distinguishing sub-parts

- 3 In respect of the submission supporting View 1 in Agenda Paper 8.2, the OS considers it would be inappropriate to componentise the wearing surface (gravel) further as the recyclable and non-recyclable components are physically indistinct. Accordingly, the OS disagrees with View 1, in particular the graph provided in paragraph 16 of Agenda Paper 8.2.
- 4 Consistent with the OS's additional submission, the AV's additional submission considers it "is not physically possible [to split one physical component] and even from a theoretical perspective the split would then need to be made based on the most likely future asset management treatment".

Staff view

- 5 AASB staff are of the view that componentisation of parts into sub-parts is not limited to cases in that sub-parts are physically distinct. Accordingly, AASB staff continue to consider that recyclable and non-recyclable gravel could be componentised in order to accurately reflect the assets management strategy.

Useful life

- 6 The AV's additional submission considers View 1 in Agenda Paper 8.2, in respect of the useful life of assets, is a "direct contradiction of AASB 1051 which highlights that same assets (or components) such as road earthworks may have an indefinite life and therefore are not required to be depreciated." AASB 1051 *Land Under Roads* does not consider the appropriateness of depreciating assets with indefinite useful lives. Rather, the purpose of AASB 1051 is to permit certain entities to elect whether to recognise land under roads acquired before the end of the first reporting period ending on or after 31 December 2007. Staff have confirmed the respondent was referring to AASB Interpretation 1055 *Accounting for Road Earthworks*.

7 Paragraph 1 of AASB Interpretation 1055 states:

Earthworks are carried out to prepare the land for the construction of drainage, the road pavement and seal, and other structures. Earthworks typically include clearing the land and reshaping and aligning the land surface through cutting, filling, grading and compacting soil and rock to suit the type of road to be constructed.

8 Such earthworks that are assessed as not having a limited useful life shall not be depreciated (AASB Interpretation 1055.7).¹

Staff view

9 Staff do not consider that the wearing surface gravel used in an open surface road would constitute earthworks. Consistent with paragraph 1 of AASB Interpretation 1055, road earthworks might include the clearing and levelling of earth in order to prepare the land for the road surface (gravel). Furthermore, staff consider that land, and in some circumstances, earthworks, are the only physical assets that are non-depreciable.

10 Staff think that, in contrast to earthworks, technological advancements in relation to road wearing surfaces would impact the useful life of gravel. Accordingly, consistent with View 1, staff consider that gravel does have a limited useful life due to obsolescence and therefore should be depreciated.

Asset management strategy

11 The AV's additional submission considers that changes in an asset's management strategy can create significant challenges for entities. The submitter uses an example of a road seal that originally comprises of three seals. In the example given, the asset management strategy for the periodic resealing of the road changes throughout the useful life of the road. The submitter argues that such changes in strategies create difficulties for the asset register. Concerns in relation to recognising depreciation for sophisticated assets, similar to those mentioned by the AV, are listed in paragraph 3² of AASB Interpretation 1030 *Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods*.

1 AASB Interpretation 1055 is based on the assumption that road transport will not become obsolete and, therefore, the useful life of road earthworks should not take into account transportation advancements.

2 Some commentators argue that depreciation methods that have conventionally been adopted in respect of long-lived physical assets, including infrastructure assets, are not appropriate for such assets, particularly when they are controlled by public sector entities, because, for example:

- (a) these assets have very long useful lives, are often 'complex' assets comprising a number of components and are constantly rehabilitated during the course of their lives, so that it is often not possible to develop a reliable estimate of their useful life;
- (b) variations in estimates of useful life, rate of consumption of future economic benefits (or service potential) or residual value will have a major impact on the operating result of the entity;
- (c) in practice, it is not possible to distinguish between maintenance expenditure and expenditure to enhance the future economic benefits of the asset, so that maintenance and depreciation expenses cannot be reliably determined; and
- (d) the information required to implement these depreciation methods does not 'fit' with the information necessary for asset management purposes.

Staff View

- 12 Staff consider that, consistent with paragraph 51 of AASB 116, the useful life of assets (including road seal components) should be reviewed regularly to ensure the asset management strategy matches the pattern of consumption of economic benefits. Staff consider that any changes to an asset's management strategy may impact on the useful life of an asset and would accordingly form part of the information reviewed in accordance with AASB 116.

Fair value

- 13 The OS considers the issue of componentising indistinguishable parts (for example, recyclable and non-recyclable gravel) is further confounded when any such component is fair valued. Currently, many local councils are required to fair value infrastructure assets periodically, for example every five years. The OS argues that accurately fair valuing sub-components of a road's wearing surface is not achievable. This is because the recyclable and non-recyclable components are indistinguishable.
- 14 The AV considers View 1 does not take into account the fair value of the long-life component and "would be in direct contradiction of AASB 13 which requires the valuer to take into account condition and comparability".

Staff view

- 15 Agenda Paper 8.2 does not make any assessment or assumptions in relation to fair value accounting. However, staff consider the graph provided in paragraph 16 of Agenda Paper 8.2 was prepared by the submitter on the basis that the fair value and useful life of the asset would be under constant review.
- 16 Staff understand NFP entities are having difficulties in applying the requirements in AASB 13 *Fair Value Measurement*, including the disclosure requirements of that Standard.³

3 [AASB M142 Action Alert](#).