

Monday, 20 April 2015

Australian Accounting Standards Board  
L7, 600 Bourke Street  
Melbourne, VIC 3000

## RESIDUAL VALUE

This submission is made in response to a public invitation by the Australian Accounting Standards Board (AASB) to provide comment on the Board's proposed reconsideration of a Tentative Agenda Decision on the topic of residual value in infrastructure initially handed down in February 2015.

Specifically, the Board has defined the issue as:

*“ a request to clarify whether residual value, as defined in AASB 116 Property, Plant and Equipment, includes the cost savings from the re-use of in-situ materials.”*

Liquid Pacific is a national firm of valuers and land economists whose client base is predominantly government. We have valued in excess of \$100bn worth of public sector assets in recent years and primarily for inclusion in financial statements. During this time we have experienced the development of 'value' within the public sector accounting framework and its impact on government decision making.

### Divergent Practices

In all instances, diversion from the accepted stems from a need to satisfy some other requirement. And so it appears to be the case in local government.

The valuation profession exists because there is a need for objective and independent opinion, not only on asset values but on a range of matters pertaining to property and the like. In most States, valuers are required to be licensed to practice and there would be few who are not members of industry regulating bodies, Australian Property Institute or the Royal Institution of Chartered Surveyors.

Unfortunately, there are number of businesses that profess to be valuers or have valuation expertise but lobby for outcomes which best serve their clients (or potential market), rather than adhere to any industry professional standards or legislative controls.

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Having regard to the AASB's summary of viewpoints, we concur with the view;

*"...residual value is only recognised in circumstances when an entity expects to receive consideration for an asset that is at the end of its useful life and, accordingly, would not include the cost savings from the re-use of in-situ materials;"*

There are a number of ways to deal with the issue of residual value as presented by representatives of local government and we consider the IPWEA in their submission has successfully presented one of the primary treatments.

However, we would ask the AASB not lose sight of the motivation behind submissions on this matter to date. Local government in many States find themselves subject to greater financial scrutiny now than they ever have in the past. A number of operational and financial reviews within the local government sector and the introduction of whole of government performance measures have shone the spotlight on the fragile financial nature of this government tier. Sustainable benchmarking, council mergers (voluntary or otherwise) and funding allocations are prevalent topics of local government management across the country.

Unlike the private sector which seeks to maximise depreciation to off-set tax liabilities, local government shuns the expense as it permeates measures that reflect 'sustainability'. To achieve their objectives, councils are adopting extreme measures to reduce this expense and it would appear they are now requesting the AASB legitimise this poor practice.

Residual value has in the past been a minor consideration in calculating value (market/fair value) and therefore it should of a major concern to those who have oversight that it is being elevated to something more than, as AASB116 puts it;

*"In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount."*

Our observations of valuation of public sector assets has in recent years seen a major shift away from reality based outcomes with little apparent consideration given to the recently introduced AASB13 which states;

*"Fair value is a market-based measurement, not an entity-specific measurement."*

More often we are encountering in the public sector 'designer' valuations, tailored to meet other needs of the entity rather than for use as an independent information tool for management purposes.

The following table is an actual extract from a recent report on a council's asset values. The advice was provided by a firm claiming to be valuers but in our opinion only succeeds in demonstrating the extent some local government entities will go in an attempt to minimise depreciation expense. It is a prime example of how distorted the valuation equation has become.

Table 1 - Adverse Residual Values

Class	Component	Type	Residual Value	Useful Life (yrs)
Build	Floor	Timber - STD	50%	60
Build	Floor	Timber - Heritage	50%	130
Build	Floor	Concrete - STD	50%	100
Build	Floor	Concrete - Heritage	50%	150
Build	Envelope	Concrete-STD	50%	90
Build	Envelope	Concrete-Heritage	50%	150
Build	Envelope	Timber-STD	65%	60
Build	Envelope	Timber-Heritage	65%	125
Build	Envelope	Conc Block - STD	65%	75
Build	Envelope	Conc Block-Heritage	65%	150
Build	Envelope	Cavity Brick-STD	65%	70
Build	Envelope	Cavity Brick-Heritage	65%	150
Build	Envelope	Brick Vaneer-STD	65%	70
Build	Envelope	C/Bond M/Deck-STD	65%	45
Build	Envelope	Fibre Cement-STD	50%	65
Build	Envelope	Corr Galv Iron-STD	65%	45
Build	Envelope	Corr Galv Iron-Heritage	65%	150
Build	Envelope	Corr Asbestos-STD	35%	40

According to the experts that developed this advice, corrugated asbestos sheeting used to clad buildings would have an end-of-life value equivalent to 35% of its cost when new!

Obviously, the above is a ridiculous set of assumptions but not surprisingly it is heavily consumed by government as a means to curtail the more important issue of depreciation. Unfortunately auditors must be naïve in these matters; otherwise one would anticipate a plethora of qualified opinions.

Liquid Pacific believes if the AASB progresses the issue of residual value beyond the present status government will embrace residual values across all asset classes (bearing in mind many government entities refer to ‘infrastructure’ as everything that is not land) in such a way as to derive financial statements that better meet the requirements of management.

Further, we consider residual value abuse is already severely diminishing the objectives of AASB13 and the integrity of fair value and the AASB now has an opportunity to minimize this impact.

We thank you for your consideration of this submission.

Yours faithfully



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