

TO: AASB
FROM: Ken Crawford
 LG Solutions
DATE: 14 April 2015
RE: Submission on AASB Tentative Agenda Decision – Residual Value

AASB Staff Note: LG Solutions has requested that section 1.6.1 from its April monthly newsletter, LG “Debits & Credits” be included as a submission to the AASB on its Tentative Agenda Decision *Recognition of Residual Value for Infrastructure Assets*.

1.1 Latest news from the AASB

1.6.1 Residual Values

Some background

As we reported last month, the AASB let off an Infrastructure Assets “residual value bomb” in February with its tentative decision (& in our opinion “narrow” view) that:



Residual Value relates to consideration only (and even then only) when the asset is at the end of its useful life.

This decision effectively put at risk the currently used convention in Local Government whereby the recycling/reuse of Infrastructure assets (or components therein) at replacement / refurbishment are deemed to be the asset’s “residual value” with the benefit of reducing depreciation expenses and acknowledging the future economic benefit of recycling/reusing an asset at the end of its useful life.



Under the AASB’s tentative view, the recycling/re-use of infrastructure assets are NOT “sold” & by definition if they are to be re-used by the entity then they are NOT at the end of their useful life - as such **the AASB does not believe residual values can include any recycling benefits of existing assets.**



*“The Board tentatively decided that **the recognition of a residual value in AASB 116 Property, Plant and Equipment is limited to when an entity expects to receive consideration at the end of the asset’s useful life and that recognition of residual value is not appropriate when existing assets are expected to be recycled into a replacement asset**”.*



Given this view on (& implications for) Infrastructure residual values, the AASB suggested that **where a part of an asset will be used beyond the life of the existing “whole” asset, then this part should be accounted for as a component & depreciated over a longer life span.** Such a treatment would result in a similar accounting result if residual values permitted re-use/recycling values.



“The Board further noted that componentisation and determining the appropriate useful life in accordance with the requirements of AASB 116 would result in a similar outcome to the alternative approach of assuming a residual value”.



This of course meant that the Implications of the AASB’s published “tentative” view if it becomes “formal” were huge:

- Infrastructure Residual Values will all have to be eliminated,
- Existing Infrastructure Assets will have to be re-componentised across short life & long life components (& depreciated accordingly),
- Potentially higher depreciation expenses,
- Prior Period adjustments will need to be reckoned with,
- Prior Year restatements of Financial Statements need to be addressed,
- And the list goes on...

So...onto a “residual value” update.

The AASB Board are meeting on the 15th April and their tentative “residual value” decision is a topic for consideration.



To date, **two submissions (both against the AASB’s tentative “residual value” decision)** have been received from APV Valuers and Coalface Consulting Accountants and are downloadable here:

http://www.aasb.gov.au/admin/file/content102/c3/M144_A4_TAD_Residual_Value_Submissions_1-2.pdf



“Residual value” submissions to the AASB are in fact are open until 20th April and we are advocating further down that Councils email the AASB of their views via standard@aaab.gov.au.



During March, both APV & a representative from the Local Government Auditors Association (NSW) met with the Chairperson of the AASB (along with a second Board member and two AASB technical staff) to discuss the Board’s tentative “residual value”.

The feedback from this meeting & the participants is that **the AASB will not be swayed** from their (*narrow**) view that **unless a disposal is made to a third-party, then no residual can be recognised !!**

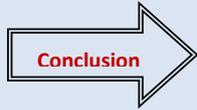
** LG Solutions words !!*

What was however discussed & ‘agreed’ at the meeting was that:

“where it can be demonstrated that recognising a residual value will not result in a material difference to the outcome achieved by further componentising the assets and extending the useful life of the “recyclable component” then it would be an acceptable argument that use of a residual was a proxy for that approach”. [Source: intentus Chartered Accountants 19/3/15]



So while the AASB are standing firm to the tentative “residual value” decision to exclude re-use/recycling benefits, **there seems to be the “out” for Councils to maintain the status quo & continue utilising Infrastructure “residual values”** where they can **demonstrate** that the financial accounting results are not materially different to the AASB’s tentative decision !!



So is it all a storm in a tea cup !?

YES & NO !!

Unless there is a change in the AASB’s view, Councils will still have to (we would presume) crunch some example numbers using the AASB’s “added componentisation & longer useful life” viewpoint for their Infrastructure assets to prove that their currently used residual value methodology and the AASB’s “more componentisation” tentative decision result in the same answers !!



Regardless of this potential “gentlemen’s agreement” compromise position...**we still think that Councils should submit a response to the AASB’s tentative “residual value” view to:**

1. Let the AASB know there is a Council voice to be heard on accounting matters,
2. Inform the AASB that their view for residual values is too “narrow” for entities that have Infrastructure Assets and,
3. Remind the AASB that there is plenty of scope for the AASB to insert an Australian only “Aus” paragraph specific to Not-for-profit entities that acknowledges re-use/residual values on Infrastructure assets & permits the definition of residual values to include such end use benefits.



We attached a word document (to this month’s newsletter email) representing an example submission “pro forma” to the AASB...but welcome Councils putting their own responses together and thereby adding more weight to the submissions received by the AASB !!

So...what to do regarding “residual values” !?

a. First up...why not email the AASB a “residual value” submission !?



We strongly urge Councils to consider submitting a response (by 20/4) to the AASB’s “tentative agenda paper” on residual values & in particular indicate an **opposition to the AASB’s published “tentative” view indicating:**

- (i) that residual values relating to Infrastructure Assets not only fit within the current Residual Value definition in AASB 116 [refer next page], but that also
- (ii) the very essence of what “depreciation expense” is all about (being the amount of an asset that is consumed over its deemed useful life) is arguably best achieved for infrastructure assets by recognising residual values (where the assets being replaced can actually contribute to a lower replacement cost than would otherwise have been possible, ie. they have a tangible re-use/recycling benefit that reduces the replacement cost).



Submissions can be made to the AASB (via standard@asb.gov.au) **up to & including 20th April, 2015.**

b. Talk to your Auditors on “residual value” audit considerations for YE 14/15 !!



We would advise Councils to talk to (& clarify with) their auditors on:

- how their auditor are going to interpret the AASB’s tentative “residual value” decision, and
- what their expectations are on audit evidence required relating to the comparison of outcomes from using:
 - a. recyclable/reuse residual values &
 - b. the AASB required alternative componentisation of long lived assets
 and whether a sampling of (a) & (b) will permit Councils to continue to use residual values methodologies for Infrastructure Assets.

Suggested AASB submission on Residual Values

We would like to register our view that the AASB tentative decision is unfairly narrow in its conclusions regarding Residual Value (as defined in AASB 116).

Under AASB 116, Residual Value is defined 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".

Regarding the "re-use/recycling" of part of an infrastructure asset that is being replaced, We believe that the benefit from "re-use/recycling" DOES fit within the current definition of "Residual Value" as per AASB 116:

- 1. An "estimated amount" can be determined in \$ terms (based on the difference between the assets complete replacement cost & recycled replacement cost),**
- 2. An entity will "currently obtain" the "amount" by paying a reduced cost of replacement (ie. cost savings have value & are "obtained" by the entity when achieved by keeping the extra cash not outlaid),**
- 3. The "amount" obtained is clearly the result of the "disposal" of the asset - being its replacement/refurbishment with a new asset.**

As such we feel the current definition of "Residual Value" as per AASB 116 IS in fact readily applicable to the "cost savings" a Council can earn/utilise by reusing or recycling (or taking early replacement) action that utilises part of the existing asset (as opposed to deferring replacement until the asset fails & requires total replacement).

We have furthermore read the dissenting submissions on the AASB's website from APV and Coalface Consulting Accountants (arguably both local government experts in their respective fields), and hope that the AASB Board take these two comprehensive submissions plus our own into account and as a result review their tentative decision on residual values once again.

If the AASB does not want such an extended "recycling/re-use" residual value to flow on to For Profit entities, we question why the AASB would not enunciate a Not-for-profit Aus paragraph to clarify the residual value definition for Not-for-profit entities only.

We would also like to put to the AASB Board that if they are unwilling to extend the definition of residual values to include a recycling/re-use aspect, that they consider in the face of the dissenting submissions (from industry experts & participants) to have the matter reviewed by the IASB's Technical Panel.