



DEFINITION OF RESIDUAL VALUE IN RELATION TO INFRASTRUCTURE ASSETS

Issue

The AASB received a request to clarify whether residual value, as defined in AASB 116 *Property, Plant and Equipment*, includes cost savings from the re-use of a part of an asset by the entity. The issue was raised primarily in relation to infrastructure assets held by not-for-profit public sector entities that are subject to rehabilitation activity over the course of the asset's useful life. The submitter contended that the definition of residual value is unduly limiting for not-for-profit entities if it does not include such cost savings.

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

The AASB noted there are two views in relation to the definition of residual value:

- View 1: residual value reflects consideration receivable for an asset that is at the end of its useful life and, accordingly, does not include cost savings from the re-use of parts of an asset by the entity; and
- View 2: the ordinary meaning of the words included in the definition of residual value could be read to include cost savings from the re-use of parts of an asset by the entity.

The AASB noted that some private sector entities may also control infrastructure assets. The AASB observed that View 2 did not appear to be widely applied in practice across sectors or other jurisdictions.

In considering this issue, the AASB noted that the definition of residual value in AASB 116 refers to the estimated amount that an entity would currently obtain from disposal of the asset at the end of its useful life to the entity. The AASB decided that the definition was sufficiently clear, and that View 2 was not an appropriate interpretation of the definition of residual value for the following reasons:

- (a) the ordinary meaning of the words needs to be considered in the context of the relevant accounting standard definition, including in conjunction with the definition of useful life;
- (b) disposal involves the entity losing control of the asset at the end of its useful life to the entity – the relocation of an asset into another asset or location does not involve any loss of control of the asset by the entity; and
- (c) where an entity has control of an asset and intends to continue to consume the future economic benefits embodied in the asset through use, the asset cannot be regarded as having reached the end of its useful life to the entity. In the case of public sector assets held for their current service potential, the useful life is unlikely to end before all of the service potential in that asset is substantially consumed, at

which time no cost savings from re-use of the asset, or a part thereof, would remain available to the entity.

The AASB observed that AASB 116 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be separately depreciated, and that parts of an asset may have a different useful life to other parts of the asset (AASB 116, paragraphs 43-45). Further, the major inspections example in AASB 116 envisages assets being separated into non-physically distinct parts – the AASB noted that a part may reflect a percentage of the asset rather than the physical materials comprising the asset (AASB 116, paragraph 14).

The AASB noted that application of View 1 and View 2 could result in differing depreciable amounts for an entity's asset, and accordingly different annual depreciation expense. The AASB observed that AASB 116 does not allow View 2 to be applied where the depreciation expense would be materially different from that which would be determined by reference to View 1. However, the AASB observed that the depreciation expense determined under View 2 might not be materially different from the expense that would have resulted had depreciation expense been determined by reference to a depreciable amount that excludes, in estimating the residual value, cost savings from the re-use of a part of the asset. The materiality of the asset to the entity and the extent to which cost savings from the re-use of parts of an asset are included in residual value are likely to affect this assessment.

On the basis of the analysis performed and in light of the existing requirements in Australian Accounting Standards, the AASB determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the AASB decided not to add this issue to its agenda.

