Townsville City Council Financial Year 2015

Accounting Position Paper – Asset Related Issues – Draft v1.1

Residual Value

The AASB has been considering the use of residual values for infrastructure assets. It has advised that residual value should be restricted to consideration received on disposal. We have been applying residual value to infrastructure assets, as have many local councils and other entities with infrastructure assets.

The definition of residual value in AASB116 is below:

The *residual value* of an asset is 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.

Using ordinary meanings of words, it is clear that the infrastructure assets are not disposed and are not at the end of their useful life when they have the life extending actions performed on them. Therefore there is no residual value as defined in AASB116 for these assets. The only residual values should be applied to Fleet units which go to auction at the end of their useful life.

Current Life Extending Practices

1. Wastewater gravity pipes are relined, giving an extended life of about 50 years.
2. Wastewater pressure pipes, particularly AC pipes under 250mm, have pipe bursting applied giving an extended life of the new pipe.
3. Road pavements that are restabilised have an extended life similar to a new pavement. Depending upon the cost of restabilisation and the road profile, the amount of original cost applied to the restabilised pavement may range from zero to say 25% - it will vary year to year.
4. Spray seal road re-surfaces applied over the existing surface may extend a portion of the original cost for up to 4 reseals.
5. Dam walls, in particular Ross River Dam, have a non-depreciable amount of 50% with a life of 50 years. The repair/refurbishment mode is typically applying additional material on the existing dam wall, not removal of the existing wall.
6. Reservoir base – typically the refurbishment mode for reservoirs will incorporate existing elements, particularly the concrete base, which will remain in use while the walls and roof are replaced. 20% of the original value of the base has been determined to extend into the refurbished reservoir.

AASB suggested treatment

In all of the above cases, a component of the original cost will extend beyond the time that relining, stabilisation etc. is applied. The AASB suggested that the physical asset be split to allow for the different life, thus creating multiple assets for the one physical asset.

Having multiple financial assets for the one physical asset (which cannot be physically divided) is an impractical solution to this issue at TCC on the following grounds:

1. Compliance with ISO55000 could not be obtained because of the complexity involved.
2. Approximately 70,000 additional assets to be created depreciated and maintained, for no addition in value to ratepayers.
3. The AASB suggested solution is an artificial one – it is not goal congruent with TCC2015 if we increase complexity and reduce functionality to asset system users.
4. Extensive and costly system modification could be required to maintain asset register integrity.
5. Maintaining the asset system register to meet audit requirements would be a living nightmare.
6. Outside trades' staff trying to link work orders to assets would be faced with significant efficiency issues because of the volume and complexity of asset numbers.

TCC Suggested Actions

The nature and remaining economic life of the infrastructure assets involved has not changed. The AASB has issued a statement giving clarity over the methodology of the accounting treatment involved by reinforcing the use of "residual values". We need to find a simple and logical methodology to reflect the new situation. In informal discussions with QAO they agree with this approach.

Note that the assets involved are not complex – a pipe, a road, a reservoir, a dam wall are all relatively simple structures that have a small number of components. They are not a complex industrial plant with thousands of divisible components that can be individually replaced.

The suggested solution is in two stages. The first stage is for an FY15 interim measure to be compliant. The second stage is a proposed long term solution that will need consultation and agreement from asset custodians, asset owners (Directors and Executive Managers), finance and auditors. The eventual solution will also aim for consistency with other Council's approaches, without having to compromise on ISO55000 asset management compliance.

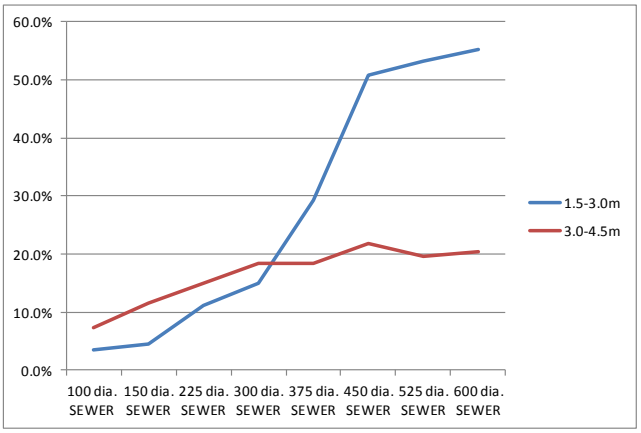
Stage 1:

Leave the residual value as it is in the CES system, continue calculating depreciation on the existing basis. Do not report the non-depreciating value in the Financial Statements as a residual value. Include in Note 1 and the Fair Value note sufficient information on the treatment of the infrastructure assets involved.

Initial testing of sample rates for wastewater gravity pipes show a variation of $220k in $1.2m depreciation between the existing approach and full componentisation. This is because residual values on fully depreciated assets are not currently depreciated, while in a componentisation model they are reactivated and depreciated over 110/130 years. This has been offset by greater granularity of residual value analysis to reduce the difference to $20k.

Pipe cost (PVC) as a percentage of total cost of a new pipe

	100 dia. SEWER	150 dia. SEWER	225 dia. SEWER	300 dia. SEWER	375 dia. SEWER	450 dia. SEWER	525 dia. SEWER	600 dia. SEWER
1.5-3.0m	3.5%	4.5%	11.1%	14.9%	29.3%	50.8%	53.1%	55.2%
3.0-4.5m	7.4%	11.5%	15.0%	18.5%	18.4%	21.9%	19.6%	20.5%



Stage 2:

When you look at the processes involved, we essentially have long life assets with a major mid-life refurbishment required to access the full life. The simple answer would be to have a single asset with stepped straight line depreciation, one step before the refurbishment and other steps after.

This type of depreciation is relatively common for major infrastructure assets. Examples are:

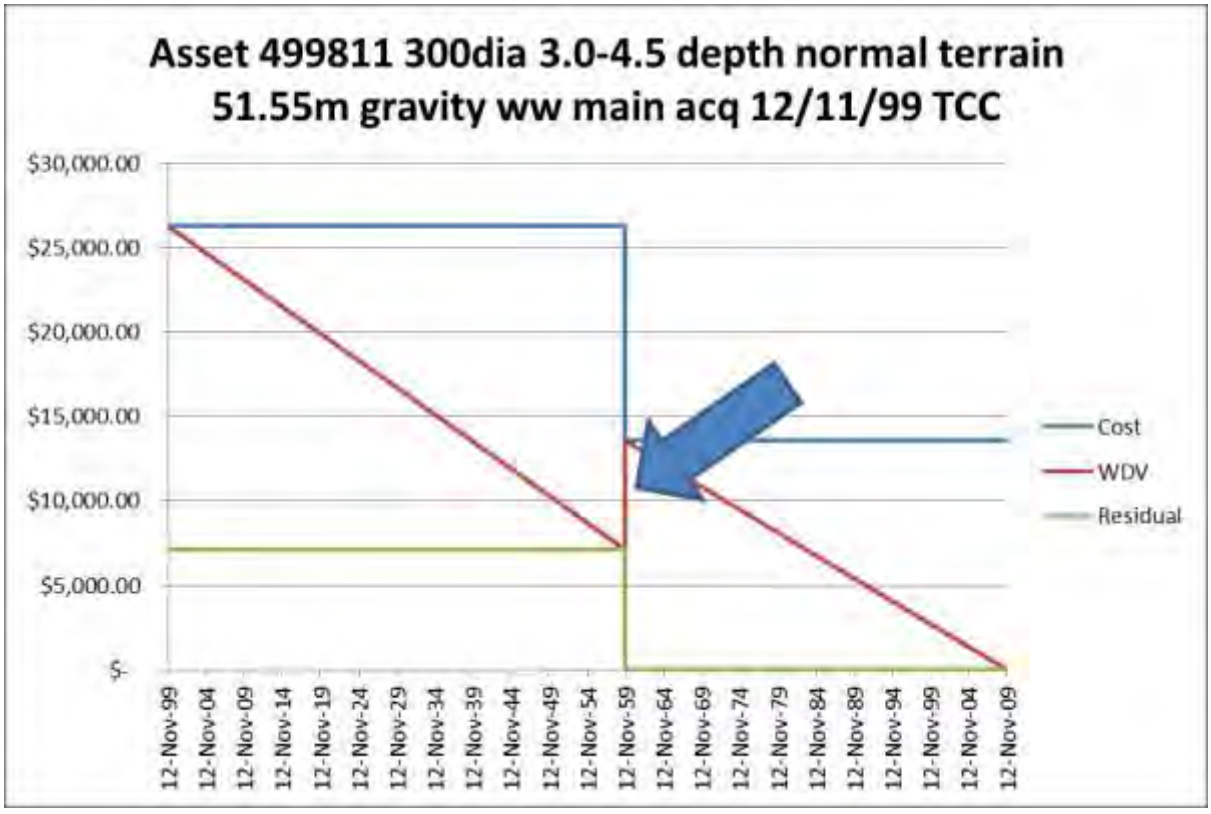
1. Suburban train sets, with a major life extending refit after 15 years use.
2. Electrical transmission lines, where the towers are depreciated but the copper lines are either not depreciated or minimally depreciated (because of the scrap value of copper)
3. Major power assets such as major electrical substations and Static VAR Compensators, where a mid-life refurbishment will give an extended life.

The second option is to keep the operational assets unchanged but to maintain linked split componentised financial registers. This is probably the best fir for pipe network assets.

The actual methodology in CES will require some changes to process, but we need to go through the consultation process before we get to that stage. Note that using this methodology will also clarify the accounting valuation of these assets – it will not change, just be easier for people to wrap their heads around it.

Example

An example of the existing treatment of a relined asset is shown graphically below. The costs that will be allocated over 110 years are trenching, design, construction and a small portion (say 10%) of the pipe. 90% of the original pipe costs are allocated over the first 60 years. All the relining costs are allocated over the second 50 years. The pipe is only a small portion of the original cost.



	1st 60 yrs.	2nd 50 yrs.
Depreciation	$ 320.39	$ 271.08

Cost of initial pipe $510 per metre, cost of relining $125 per metre.

Asset valuation on the above assets

The existing TCC treatment is in accordance with AASB116.

1. "Based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset "(par B9, p42 AASB116)

2. To make it perfectly clear, during the first step, the value is based on equivalent cost of a new pipe, while during the second step it is based on the equivalent cost of the relined pipe, plus the portion of the new pipe installation that extends over 110 years. This treatment accurately reflects the service potential of each step in the assets economic life.

Roads – Capex v Opex

The rules have not changed for FY15.

1. Isolated digouts do not generally extend the economic life of the road and are almost always opex. This is especially true if there are more than 3 digouts in a single section as in those cases the work is designed to allow the road to reach its existing remaining economic life.
2. Expenditure is generally capex if the treatment is for the full width of the road and extends for more than 50% in length of a road section. Kerb, pathway and footpath would generally need to be at least more than 50% of a road section to be considered as capex.
3. There are always exceptions which would be decided on a case by case basis, and confirmed with the appropriate responsible engineer. The key decision trigger is whether the remaining economic life of the road component has been extended by the works.
4. The program from which the works were funded is only a guide. Road Reconstruction, Preventative Maintenance, NDRRA are descriptors for the program funding source, not indications on whether the works are capex or opex. It is the delivered scope of the job that is important.

Expenditure on obsolete and refurbished assets – disposal costs or included in the cost of the new asset?

Once again, we have not had any change in methodology or practice for this year.

1. Core filling of redundant stormwater pipes is a disposal cost of the old asset, even though the new alignment may run alongside the existing pipe. The core filling occurs to prevent the old pipe collapsing and causing subsidence, it is not related to the delivery of service potential from the new pipe.
2. Demolition and make good costs of bus stops that are removed replaced or relocated – are disposal costs of the old asset.
3. Landfill cell capping – permanent capping at the end of a landfill cell or stage is performed once only and funded from the capping and restoration provision. Interim capping to meet ongoing operational licence conditions on dust and odour etc. are operational expenses. Stormwater and leachate for newly constructed cells are capex. When the landfill stage is permanently capped, the related stormwater and leachate expenditure at that time is funded from the provision.
4. Landfill – after capping is complete – monitoring and testing required for the next 50 odd years once capping is complete is not funded from the provision and is opex.
5. Asbestos removal costs are nearly always opex. The new major fitout once the asbestos is removed will be capex, ongoing replacements of office furniture thereafter is opex. It may be that the removal of the asbestos in a market value building will cause an increase in market value simply because of that work – in that case it could be capex. Each case is decided on the facts and by applying the accounting standards.

Sustainability – classification of renewal v upgrade/new capex

The methodology applied in the last two years is unchanged.

1. If an existing asset is replaced, like for like in terms of service capacity or a close approximation thereof, it is renewal.
2. If an existing asset is replaced and substantially upgraded, it is both renewal and upgrade/new. An example is Blakeys Crossing – the equivalent rate for the old pavement and surface (for a road of the old standard) is renewal, the remainder is upgrade/new.
3. New capex expenditure is generally self-evident.
4. While the function codes applied to expenditure on the project capital work orders are a useful guide, the final determination of renewal/upgrade/new has to be based on the nature of the project and the assets that were capitalised. If necessary, expenditure should be reallocated between the different classifications of sustainability so that the Financial Statements accurately reflect the actual work that took place. This will be performed by Asset Accounting while performing end of year statement preparation.

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