Submission

AASB Tentative Agenda Decision Regarding Residual Value

Interest Group

This submission is on behalf of the NSW Northern Rivers group of Councils including:

- Tweed Shire Council
- Lismore City Council
- Byron Shire Council
- Clarence Valley Council
- Richmond River County Council
- Ballina Shire Council

The interest of this group relates to the board's tentative decision regarding the treatment of the re-use/recycling of in-situ materials in relation to the residual value of infrastructure assets.

The board has taken the view that a residual value would only be recognised when an entity expects to receive consideration for an asset at the end of its useful life. Accordingly, residual value would not include the cost savings from the re-use of in-situ materials.

Application of Residual Value to the Re-use/Recycling of In-situ Materials

For not-for-profit entities infrastructure assets are predominantly commissioned with the expectation they will be replaced. The group believes it is the expectation of replacement of infrastructure assets that substantiates the application of the residual value for future cost savings gained by reusing or recycling materials forming part of an asset.

AASB 116 provides the following definitions:

- Residual Value
  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.

- Useful Life
  a) *the period over which an asset is expected to be available for use by an entity*
  b) *the number of production or similar units expected to be obtained from the asset by the entity*

The following analysis supports the argument that future cost savings from the re-use of in-situ materials fits within the current definition of "residual value".

An "estimated amount" can be determined based on the difference between the assets complete replacement cost and the cost of replacement less the cost that would be incurred if the re-used/recycled materials are purchased upon replacement of the asset. This cost saving is the amount the entity would "currently obtain" as a result of disposal and subsequent replacement of the asset "in the condition expected at the end of its useful life" as opposed to deferring the replacement until the asset fails and requires total replacement.

There are many reasons why an asset would be replaced before the point of failure including, risk factors, reduced maintenance expenditure and the maintaining of service potential and functionality. Consideration is given to these factors when assigning the useful life and residual value based on "the condition expected at the end of (the assets) useful life."

An example of this is a road pavement asset. A road pavement contains a portion of materials that is re-used in the reconstruction process. When the original pavement is laid, there is an expectation that this asset will be replaced at a future point in time before the point of failure - the end of its useful life. This would be the point where the asset is expected to be no longer available for use in consideration of risk, economic viability, serviceability and functional reasons. The residual value applied to the road pavement equates to the amount of cost savings achievable by re-using a portion of the original materials upon disposal and subsequent replacement of the asset when it reaches this point. Specifically, "the estimated amount the entity would currently obtain from the disposal of the asset", "if the asset were already of the age and in the condition expected at the end of its useful life."

<u>Componentisation of Recyclable and Non-recyclable Asset Components</u>
The AASB also noted that "adequate componentisation of parts of an item of property, plant and equipment, and appropriate estimation of useful lives of such parts, would result in a similar overall depreciation expense" if re-use of in-situ materials were either included or not included in residual values.

By "adequate componentisation of parts of an item of property, plant and equipment, and appropriate estimation of useful lives of such parts" the AASB appear to be supporting a view that any portion of an asset component considered to be residual or recyclable should be accounted for as a separate component with a longer useful life than the non-recyclable portion of the asset component.

This creates another set of issues including:

- A single financial/operating point of truth asset register could not be utilised as the financial register would have more components then the operational register;
- Links between financial and operating registers would not be possible if financial assets were further componentised;
- Links between financial asset registers and GIS spatial asset registers would not be possible if financial assets were further componentised;
- The difficulty in determining useful lives of residual components given the potential extraordinary long life of some materials;
- If the further componentisation method is not adopted and residual values are not applied, it will result in an over statement of depreciation on an annual

basis and an adjustment to the revaluation reserve on revaluation which will then be depreciated again through the P & L;

- Long term financial modelling for asset replacement forecasts will be complicated by the financial asset register and the operating asset register not being aligned. Treatment history will be applied to a single operating asset with financial values applied to multiple financial assets.

In conclusion, the group believe residual values relating to the re-use/recycling of materials forming part of an asset or a component of an asset fit within the current definition of "residual value". Accordingly, we support the view that separation of short and long life components is not required and runs contrary to best practice asset management principles.

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