



Tax & Accounting Newsletter

How to understand 'residual value' and its importance

With regard to the amendments to the accounting legislation, we would like to further discuss one of the new provisions of Decree No. 500/2009 Coll., which deals with residual value, namely Section § 56 (3), pursuant to which an accounting entity can – in respect of the materiality and true and fair view of a company's accounts – allow for the estimated residual value at the time of asset depreciation and amortisation.

Estimated residual value means the positive estimated amount an accounting entity could justify, and would obtain, upon the estimated disposal of assets through, for example, sale – after deducting estimated costs related to such disposal.

A typical example of residual value would be the disposal of a passenger car: The accounting entity estimates that the economic life of the car will be, for example, four years, and that it would then be sold for CZK 50 thousand (after deducting all costs relating to the disposal). Let's assume in our example that the car was purchased on 1 January 2008.

The acquisition price of the car is CZK 370,000.

The depreciable amount, taking into account the residual value, would be:

370,000 – 50,000 =. CZK 320,000

Monthly depreciation would be: **320,000 : 4 : 12 = CZK 6,666**

Unless an unexpected event took place, or the estimated economic life and residual value of the car changed, the car would be sold on 31 December 2011, i.e. proceeds associated with the selling price would be realized and, at the same time, the net book (residual) value of the car would be deducted upon disposal.

Through this procedure, the entity would clearly fulfil the historical cost and accrual principles as stated in **Act No. 563/1991 Coll., on accounting**.

Like other estimates, the residual value estimate is reviewed on an annual basis which means it could change over the economic life of the asset.

If the accounting entity estimates the residual value for the first time in the 2009 period, the estimate will not be considered a change in accounting method – i.e. retrospectively – but rather as a change in the estimate. Consequently, it will be recorded compared to profit or loss for the current and subsequent accounting periods.

The real question is who makes the estimates in respect of both the economic life and the residual value of fixed assets? Among those who should certainly be involved are technicians and/or other experts in the accounting entity; not only the accounting department, which does not have all necessary information.

If you wish to determine your fixed asset residual value and depreciable amount calculation monitoring process, or review depreciation calculation methodology, we will be happy to assist you.



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