ASSET VALUATION POLICY

Minute Number: (2014/7/22/11.1)
Adopted on: (22 July 2014)

1. LEGISLATIVE AUTHORITY

Australian Accounting Standards

- AASB13 – Fair Value Measurement

2. BACKGROUND AND/OR PRINCIPLES

2.1 The Framework for the Preparation and Presentation of Financial Statements (the Framework) identifies four principal characteristics that make the information provided in financial reports useful to users: understanding, relevance, reliability and comparability. Other important factors in the recording of assets are timeliness, materiality and cost versus benefit.

This policy takes the position that, for the most part, the characteristics of relevance and reliability will be met by valuing non-current physical at their fair value, as defined in AASB 13 Fair Value Measurement rather than at cost**.**

Whitsunday Regional Council shall value all asset classes at fair value. These classes include land, buildings, buildings-other structures, roads, water and sewerage.

Investment property is to be recorded at fair value except where fair value cannot be measured reliably. An intangible asset is to be carried at cost except when there is an active market for that asset.

2.2 Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same – to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Because fair value is a market based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Standard shall be applied to an entity's own equity instruments measured at fair value.

3. DEFINITIONS

AASB 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

To calculate a fair value pursuant to AASB 13, information must be obtained, and/or assumptions made, about a range of factors, including but not limited to:

• the characteristics e.g. the condition and location of the asset and restrictions, if any, on sale or use of the asset;

• which market a sale of that asset would take place in;

• what is the highest and best use for the asset; and

• which costs are to be taken into account (e.g. transaction costs are not to be included, as per AASB 13.).

The data used for the fair value calculation must reflect the information and assumptions that market participants would use when pricing the asset, not necessarily how an agency currently uses, or intends to use, the asset.

4. GENERAL INFORMATION

Valuation approaches

Valuation techniques used to calculate fair value fall into either of the following approaches:

- a market approach;
- an income approach; or
- a cost approach

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value by maximising the use of observable inputs and minimising the use of unobservable inputs.

Market approach

When observable data for similar assets is available, that data is likely to represent the best indicator of the asset's fair value. For that reason, some land and general non-specialised buildings could be valued using a market approach.

Where an asset is rarely traded and reliable comparisons with similar assets do not exist, other valuation approaches such as the income approach (if the highest and best use of the asset is to generate net cash inflows) or cost approach may be more appropriate.

Income approach

i) *Discounted cash flow technique*

The income approach will generally be more relevant to assets where their highest and best use is primarily dependent on their ability to generate net cash inflows, such as commercial or general office buildings. The discounted cash flow (DCF) technique is a commonly used technique under the income approach.

The DCF technique involves:

- estimating the future cash inflows, outflows and appropriate terminal value to be derived from the asset(s) (or cash-generating unit); and
- applying an appropriate discount rate to those future cash flows

The key assumptions and variables used in the DCF technique must be supportable based on objective evidence and reasoned judgement. If this cannot be achieved then fair value cannot be reliably estimated using the DCF technique.

If Council adopts the income approach for an asset group, this total value is to be allocated across the individual assets in the group in a manner as determined and documented by Council. Where the value of the individual assets cannot be reliably determined, the value attributable to the group is apportioned to the individual assets. The ratio of the value of an asset to the value of the group may be an appropriate basis for such an apportionment

ii) Regulated Asset Base

Whitsunday Regional Council operates in a price-regulated industry, such as those operating in the mining and water treatment sectors. It is generally accepted that assets owned by these entities are held to generate cash inflows.

Where there is no market price for identical or similar assets, fair value may be determined using either a cost approach or an income approach.

In Queensland, it is generally accepted that little or no active market exists for price regulated activities undertaken by local government agencies. Indicators of a lack of an active market for price-regulated assets include situations where the assets are:

- complex in nature requiring specialist expertise to design and construct;
- unique to a particular market; and
- rarely sold

In price-regulated industries, the regulator uses the value of the group of assets (known as the asset base) employed in the delivery of the services subject to regulatory requirements for determining prices for the services and products delivered and supplied by the agency.

The value of the asset base is known as the Regulatory Asset Base (RAB).

'*The RAB is the 'market value' of the business based on its potential to earn revenue under existing Regulatory arrangements*.'

For financial reporting purposes, the value of the RAB, as assessed by the regulator, is **not to be assumed** by a Council to be the measure of fair value for the asset group. However, Council should consider whether any of the inputs and assumptions used in determining RAB might be an appropriate basis for determining fair value using an income approach.

In Australia there is no consistent, or generally accepted, methodology to determine the value of the RAB across the different price-regulated industries. In some price-regulated industries, the 'building-block approach' has been adopted to determine the RAB value.

This approach includes quantifying the cost components of service provision and a revenue target sufficient to meet those costs for each regulatory period, usually five years. The cost components include:

- quantification of the required rate of return (return on capital);
- allowance for return of capital (depreciation based on existing assets); and
- operating costs (both recurrent and capital).

Cost approach

Depreciated replacement cost (DRC) is the most common valuation technique under the cost approach.

DRC reflects the cost to acquire the service potential embodied in an asset, adjusted to reflect the asset's present condition/physical deterioration, functionality and technological and/or economic obsolescence. Where the remaining service potential from the asset is assessed as having changed, this is to be taken into account in the revaluation. Adjustments to useful life may also be required.

Sufficient knowledge of the asset circumstances is required in order to properly assess the asset's remaining service potential and physical/economic/functional obsolescence.

DRC can be determined in one of two ways:

- as the cost per unit of service potential of the most appropriate modern replacement facility, adjusted for any differences in future service potential (i.e. quality and quantity of outputs, useful life and over-design/over-capacity) of the asset being valued; or
- as the cost of reproducing or replicating the future service potential of the asset itself.

The application of DRC should capture all of the costs (i.e. materials, labour, design etc) that would be incurred at the date of valuation by a market participant seeking to construct an asset with comparable service potential. Where Council has records of actual construction costs for a new asset, those costs are relevant to the asset being valued, and Council is confident there is no significant change in those costs between the date of completion and date of valuation, those actual costs of construction may be used as an appropriate starting point for DRC.

SPECIFIC VALUATION ISSUES

Acquisition Other Than Fair Value

Transaction prices are generally presumed as the best evidence of fair value of an asset at initial recognition. However, there might be situations where this presumption can't be supported, and such circumstances include where:

- the transaction was not entered into on commercial or arm's length terms;
- no or nominal consideration was provided by the recipient;
- there is evidence that the transaction price does not materially reflect the underlying value of the asset; or
- the situations detailed in AASB 13 paragraph B4 exist.

Contributed assets must be valued according to what is outlined in the **Contributed Assets Policy**.

No Reliable Value Available

There may be instances when it is impossible to obtain a reliable fair value for an asset because of its unique nature or because its future economic benefits cannot be measured reliably. In such a case, the agency must disclose details of that asset in the notes to its financial statements giving reasons why a reliable fair value is not available. Such assets are held at nil value until a reliable fair value can be ascertained. These instances should be rare and every effort should be made to obtain a realistic valuation.

Heritage, Artworks and Cultural Assets

Council may control assets of significant heritage and cultural "value". These may be preserved solely for these attributes, or used in Council operations. It is important to distinguish between the heritage characteristics of such assets and their functional or operational value. The fact that an asset is not included on an official 'heritage listing' does not prevent it from having heritage characteristics.

The valuation of property with heritage or cultural attributes is essentially the same as for other non-current physical assets.

In cases where the values of heritage and cultural assets cannot be measured reliably, the assets are not to be recognised in the Statement of Financial Position but disclosed as a note to the financial statements. This disclosure should state the reason why the asset cannot be reliably valued and include the nature of the asset, the purposes for which it is held and, to the extent practicable, the annual costs of maintenance/preservation.

Instances of this nature should be rare and agencies are required to make every effort to value heritage and cultural assets at their fair value.

Investment Property

Investment property is to be initially recognised at cost, including transaction costs as per AASB 140 *Investment Property*. After initial recognition Council must measure all of its investment property, including investment property under construction, at fair value except where fair value cannot be measured reliably. Fair value is to be determined in accordance with the principles and requirements of AASB 13.

A gain or loss arising from a change in the fair value of an investment property is to be recognised in the agency's operating result for the period in which it arises.

Leased Assets

AASB 117 *Leases* requires that assets acquired under finance leases be recognised initially at amounts equal to the fair value of the leased property or if lower, the present value of the minimum lease payments using the interest rate implicit in the original lease contract as the discount factor. A corresponding liability for lease payments must also be recorded.

Assets acquired under a finance lease are subject to the same revaluation requirements as assets that are owned or otherwise controlled/administered by Council.

AASB 117 uses the term 'fair value' in a way that differs in some respects from the definition of fair value in AASB 13. Therefore, leasing transactions covered by AASB 117 are not subject to the measurement and disclosure requirements of AASB 13.

5. POLICY STATEMENT

In terms of AASB 116, it is Whitsunday Regional Council's policy that a 'significant' change in value has occurred when there are indicators to suggest that the value of the asset class has changed by 10% or more.

For the purposes of this policy, an asset class is deemed to be 'highly volatile' if the upward or downward movement in the value of that class is rapid over a short period of time. An asset class is perceived to have 'low volatility' if the value of the class changes steadily and slowly over the medium to long term.

To ensure the carrying amounts of asset classes reflect their fair value at reporting date, it is Whitsunday Regional Council's policy to revalue the asset classes identified in MyData, (the asset management system) annually, subject to materiality.

Council must adhere to a process to identify subsequent changed circumstances that would cause the recognised fair values to differ materially from their fair values at the end of the reporting period. Where such changed circumstances do exist, Council must arrange for the fair values concerned to be reviewed and revised accordingly.

For asset classes that are required to be carried at fair value, the concept of materiality described in AASB 1031 Materiality should be considered. On that basis:

- where the total value of Council's assets in a mandatory asset class is immaterial, compared to the total balance of Property Plant and Equipment, Council has discretion about whether or not to revalue (by any method);

- where the change in the value of an asset class is immaterial, Council has discretion about whether or not to account for that change; and

If Council chooses to revalue assets despite their immateriality, the fair value and revaluation requirements in AASB 13, AASB 116 and the Non-Current Asset Policies still apply.

Revaluation of an asset class incorporates either or both of the following methods:

- specific appraisals undertaken by an independent professional valuer (or other relevant professional) or internal expert; and

- use of appropriate and relevant indices.

Independent professional valuer (or other relevant professional) or internal expert

All non-current physical assets to be measured at fair value must be revalued by a suitably qualified person at least once every four years. Where indicators exist that the asset class has experienced a significant and volatile change in value since the last reporting period, all assets in that class should be considered for specific appraisal, if practicable. In the case of land valuations, valuers registered in Queensland are required. For other assets, depending on the valuation approach, quantity surveyors or engineers may have appropriate expertise.

Use of indices

Council must assess the suitability of the indices recommended for the assets concerned. Reasons for adjustments made to observable/industry indices must be clearly documented and approved by management.

The use of indices may be limited by the availability and timeliness of an index appropriate to a particular type of asset. As far as possible, indices used must maximise the use of observable data and minimise the use of unobservable data. Indices applied to asset values should ideally be consistent with the underlying data inputs used for the last specific appraisal.

Council must ensure that the application of such indices would result in a valid estimation of the asset's fair value at reporting date. This requires that Council ensure there is sufficient evidence that the index used is robust, valid and appropriate to the assets to which it is being applied. The process of ensuring there is evidence should include, but not necessarily be limited to:

- seeking assurances from an expert (e.g. an independent professional valuer or other relevant professional (internal or external to the agency) with the skills and experience considered appropriate to provide such assurances to management) that the index used is robust, valid and appropriate to the assets to which it is being applied;
- testing, and periodic reviews, of the appropriateness of the index to an asset (or sample of assets) for reasonableness, including (but not limited to) comparing the results to similar assets that have been valued by an independent professional valuer (or other relevant professional) or internal expert;
- ensuring any significant trends or short-term volatility are reflected in the determination of the index, and assessing whether any further procedures (e.g. a specific appraisal) are warranted; and
- documenting this process of assurance, the assumptions and findings from the assurance process.

An independent professional valuer (or other relevant professional) is **not** required to certify that the application of the index to the assets within the particular class results in the value of the class reflecting fair value. Index rates will be applied by referring to various professional publications and in consultation with internal managers.

Council has the option of choosing only to account for the impact of indexation if the cumulative change in the index results in a 5% or greater (either positive or negative) change in the reported asset balances.

AASB 13 requires disclosures about any changes in valuation techniques during the reporting period and information about new valuation techniques. For the purpose of this disclosure, the application of indices between specific appraisals should not be regarded as a change of valuation technique.

6. POLICY OBJECTIVES

It is necessary that regular revaluations be performed to ensure the carrying amount of the assets do not differ materially from their fair value at the end of each reporting period, as required by AASB 116 Property Plant and Equipment. Therefore, in all circumstances, Council must have reasonable, robust and supportable evidence that the resulting asset class values materially represent fair value at reporting date. AASB 116 states that the frequency of revaluations will depend upon the changes in fair values of the items of property, plant and equipment being revalued. AASB 116 further states that for property, plant and equipment as sets that experience significant and volatile changes in fair value, annual revaluation will be required.

In terms of AASB 116, it is Whitsunday Regional Council's policy that a 'significant' change in value has occurred when there are indicators to suggest that the value of the asset class has changed by 10% or more.

7. ASSOCIATED POLICY PROCEDURES

Contributed Assets Policy

8. IMPLEMENTATION AND EVALUTATION

This Policy is authorised for endorsement by the CEO and implemented by the Asset Accountant.

9. DATE REVIEWED

This Policy should be reviewed on a minimum annual basis and updated with:

- Changes to Australian Accounting Standards

10. NEXT REVIEW

Refer above