

Guidance Note

Fair Value Asset Valuation Methodologies for Victorian Local Governments



The Application of
AASB116 for the valuation
of Non-Current Physical
Assets (property, plant and
equipment) for Financial
Reporting purposes in the
Victorian Local
Government context



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Introduction

The “*Results of 30 June 2004 Financial statement and other audits*” for local government, tabled in December 2004 by Auditor-General Victoria (AGV), recommended the development of an agreed methodology for the valuation of comparable land assets owned or controlled by councils. The recommendation (14.3) was that to achieve this, councils should work with the Department for Victorian Communities (DVC) and Valuer-General Victoria (VGV).

It was subsequently agreed that DVC work in conjunction with AGV and VGV to consult with relevant peak bodies and issue a guidance note for practitioners.

In view of the introduction of Australian equivalents to international financial reporting standards (A-IFRS) from 2005, and in particular AASB 116 “Property, Plant and Equipment” and its implications for financial reporting in all sectors of the community, it was decided to extend the discussion paper and subsequent guidance notes to cover other local government financial reporting valuation methodologies, other than just “land”.

While VGV has completed the majority of the work in drafting these guidelines, they have been produced in conjunction with and are endorsed by the AGV and DVC.

Purpose

This document is a guide to those in Victorian local government involved with valuations of non-current physical assets for effective asset management and for financial reporting. It provides advice on methodologies for obtaining appropriate and consistent valuations across the Victorian local government sector (refer to AAS 27 paragraph 12 for definition). It does not deal with how to account for the valuation changes.

These guidelines are not intended to be definitive, rather it is a first step towards recognition of changes because of the implementation of AASB 116 in the Australian valuation and financial reporting context.

The paper has drawn upon information available from a number of sources. A list of references is provided at the end of this paper. Valuers are required to bear in mind all the information and definitions of two main references:

- Australian Accounting Standards Board (AASB) standard – AASB 116 (Property, Plant & Equipment)
- Australian Property Institute Guidance Notes and Practice Standards

In addition, the Valuers-General “fair value decision tree” has been inserted in this paper to give valuers some high level general guidance on the decision process when deciding asset valuation methodology.

1. General requirements of AASB 116

The operative date for the introduction of all Australian equivalents to international reporting standards (A-IFRS), including AASB 116 "Property, Plant and Equipment" was from the first reporting period on or after 1 January 2005. For local governments this will be the financial year ended 30 June 2006. Comparative figures for the year ending 30 June 2005 will need to be restated in the 2005-06 statements.

The new financial reporting standards are applicable to private and public sector agencies including state and local governments. They are "sector-neutral" standards and apply equally to "not for profit" and "for profit" entities. The local government sector is generally regarded as comprising "not for profit" entities.

Please refer to the Australian Accounting Standards Board website at www.aasb.com.au and become a subscriber to keep up to date with changes in financial reporting standards as they occur.

It is expected that AASB 116 will "subsume" the relevant parts of AAS 27 and AAS 29 (Financial Reporting by Government Departments) once in full operation, thereby placing both local government and state governments under the same set of financial reporting standards right across Australia.

1.1. Disclosures

Valuers should be aware of certain financial reporting disclosures that need to be made in respect to revaluations. Refer to AASB 116 paragraphs 73 to 77 for details.

Without limiting the disclosures required under AASB 116 the following are suggested items for the valuer to include in their report:

- a) the nature of the instructions and the purpose of the valuation;
- b) the name and qualifications of the valuer;
- c) the basis of the valuation, including the definition of "value" and the methodology applied;
- d) the tenure of assets and classification of rights valued;
- e) the date of valuation and for which reporting period it applies;
- f) the identification of the assets and their locations as well as the date and extent of the inspections;
- g) the applicable regulatory framework; and
- h) special assumptions and/or limiting condition.

Refer to International Valuation Standards Committee (IVSC) *International Valuation Standards 2005*, page 108, for a detailed list of other disclosures.

1.2. Recognition and subsequent measurement

All new assets are measured initially at their cost of acquisition. Where an asset is acquired at no cost, the cost of acquisition is deemed to be the asset's fair value.

Cost of acquisition is now defined to include, where relevant, the initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located. This is a new requirement, not previously applied in the Australian context, and will impact on fair value where depreciated replacement cost (DRC) is used.

DRC "is the current replacement cost of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset" (AASB 166 Australian Guidance paragraph G5).

After its initial recognition an asset can continue to be measured at cost, or a council may elect to subsequently measure it on a cost or fair value basis. Whichever measurement model is adopted all assets in the class to which the asset belongs must be measured on the same basis.

If a class of assets is measured at fair value, it is a requirement that the carrying amount of that class of assets, as set out in the annual financial statements, is not materially different from the actual fair value of that class at the date of the financial year end (generally 30 June). Accordingly, revaluations of a class of assets will need to be undertaken with sufficient regularity for this requirement to be satisfied.

Each municipality should adopt its own revaluation schedule for its various asset classes. Progressive (or rolling) revaluation of a class of assets is permitted where the revaluation process is completed within a short timeframe, that is within the financial year.

Assets that have been acquired within 12 months of the reporting date will need to be revalued if there is evidence that the asset's carrying value (i.e. initial acquisition cost less accumulated depreciation) is materially different to its "fair value".

2. Fair value – general concepts

The following discussion relates to assets and classes of assets where the council has elected to adopt fair value measurement subsequent to initial acquisition. It can also be used when a council needs to determine a deemed cost for assets initially acquired at no cost.

It is a matter for the council to determine which classes of assets will be measured subsequently at cost and at fair value. This paper does not address that decision.

The fair value of an asset is the best estimate of the price reasonably obtainable in the market at the date of the valuation.

AASB 116 (paragraph 6) defines fair value as “the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction”.

“It is the most advantageous price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. The estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, or concessions granted by anyone associated with the sale.” (AASB 116 Australian Guidance paragraph G1)

Underlying the definition of fair value is a presumption that the entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Similarly, to determine the fair value of an asset, it is assumed that the asset is exchanged after an adequate period of marketing to obtain its most advantageous price.

The fair value of an asset is determined by reference to its highest and best use, that is, the use of the asset that is physically possible, legally permissible and financially feasible; and as such results in the highest value. Opportunities that are not available to the entity are not taken into account. AASB 116 states that “where it is the market’s assessment that it is rational to continue to use the asset, the revalued amount shall include estimated entry costs”¹. However, the allocation of entry costs such as stamp duty and fees needs to be carefully considered and the valuer is reminded to look to market based evidence rather than arbitrarily increasing a valuation amount to include start up or entry costs.

Where a quoted market price in an active and liquid market is available for an asset, that price represents the best evidence of the asset’s fair value. When a quoted market price for the asset in an active and liquid market is not available, the fair value is estimated by reference to the best available market evidence of the price for which the asset could be exchanged between knowledgeable, willing parties in an arms length transaction. This evidence includes current market prices for assets that are similar in use, type and condition, (similar assets) and the price of the most recent transaction for the same or a similar asset (provided there has not been a significant change in economic circumstances between the transaction date and the reporting date).

“Current market prices for the same or similar assets can usually be observed for land, non-specialised buildings, used motor vehicles, and some forms of plant and equipment. For land and buildings these prices can also be derived from observable market evidence (eg. observable current market rentals) using discounted cash flow analysis.” (AASB 116 Australian Guidance paragraph G3)

In some circumstances, the fair value of the asset is not able to be determined from market-based evidence. The market buying price and market selling price of an asset differ materially because the asset is usually bought separately in the new asset market, but if sold separately could only be sold for its residual value. In other circumstances the fair value of the asset is not able to be determined from market-based evidence, as there is no market evidence of the asset’s market selling price. These circumstances will usually arise where the transaction price evidence arises *“in a monopoly context or the asset is specialised and rarely sold, except as part of a continuing business”* (AASB 116 Australian Guidance paragraph G4).

If the fair value of an item of property, plant and equipment cannot be reliably determined using market-based evidence as outlined in paragraph 33 of the standard, the asset’s fair value is measured at its market buying price. The best indicator of an asset’s market buying price is either depreciated replacement cost (DRC) or an income approach. Only where the future economic benefits of an asset are **primarily dependent** on its ability to generate net cash inflows should the income approach be applied. In all other cases, the depreciated replacement cost approach should be more appropriate.

¹ Where the asset is held for sale or is to be abandoned refer to AASB 5 “Non-Current Assets Held for Sale and Discontinued Operations” (paragraph G2)

3. Revaluation of non-current physical assets

For asset management and accounting purposes local government non-current assets are generally divided into categories and classes. Individual non-current physical assets (NCPA) are broken down into horizontal components and vertical segments. This paper does not deal with the issues of classification, componentisation or segmentation of NCPA. Further information on this issue can be found in the "Accounting for non-current physical assets under A-IFRS - a guide 2006" available from the DVC website www.dvc.vic.gov.au

3.1. Valuation of land

The valuation of land at fair value must have regard to its highest and best use (AASB 116 Australian Guidance paragraph G2).

It means adopting a highest and best use that is legal and feasible. Land should be valued at fair value and measured having regard to the highest and best use when and only when there exists possible and feasible alternative uses in the existing natural, legal, financial and socio-political environment and the alternative uses are feasible within the near future. Fair value needs to be considered in the context of allowing for the costs of achieving the highest and best use.

In assessing a feasible alternative use, general zoning restrictions should be distinguished from restrictions on current use that are placed on land by state or local government. A state government example may be an agricultural research station on the fringe of an expanding urban development. It is not to be assumed that the only use to which this land could be put in the future would be for its specific purpose. Where there is special zoning it may reflect the mechanism by which the State Government, as owner, recognises its current use.

These restrictions, even if reflected in special zoning, should not provide the basis on which the feasible highest and best use valuation is made. The types of zoning that would usually be relevant are general types of zoning such as residential, commercial and industrial, while special zoning will reflect the restricted use such as a "public purpose reservation", floodway use, community use, council use etc.

In the public sector, some land can be valued having regard to highest and best use. This includes Crown land that is designated for development and/or disposal, and land under general-purpose buildings or plant.

However in the state and local government sector there can be natural, legal, financial or socio-political restrictions on the use and disposal of land. Some land in the state and local government sector is held as community, cultural or heritage assets or is land under assets held for these purposes. Further, government/ministerial directives or legal administrative requirements to continue to provide the community services that the land has been designated for, mandate most public entities. The same can be said equally for the state and local government sectors.

Where there are natural, legal, financial or socio-political restrictions on use and disposal of land, and there is no feasible alternative use in the near future, the land should be valued at fair (market) value for its existing use. That is, opportunities that are not available to the entity are not taken into account. This is consistent with the AASB 116 (Australian Guidance paragraph G2). Land assets in the public sector with no feasible alternative use include parks and gardens, national parks and reserves that are held for public benefit (community service obligations) and vacant Crown land. Council reserves and parks (non-Crown land) would also be in this situation.

In addition, the needs for provision of service delivery impose restrictions on the use of land under specialised buildings or infrastructure assets held and used for obligated purposes. Such requirements (mandates) may eliminate any possible highest and best use value related to an alternative use or arising from any redevelopment potential of the land. For example, in the public sector, an examination of Victorian railway corridors indicates that few sections in the metropolitan area have potential for alternative use.

Similarly possible uses for land under Parliament House, Government House and historic and similar heritage buildings are limited to the extent of the restricted feasible alternative uses of the buildings. The same could be said for heritage-listed local municipal offices or town halls.

For other land under assets, the land may have feasible alternative uses because it may be possible to relocate the assets used to provide the service. A fire station located in the centre of a country town may be moved to the outskirts if the service believes that to be a better location for the asset. In other cases, the asset on the land may no longer be required in that location because of changes in demographics over time or consolidation of services for strategic and efficiency reasons (such as kindergartens and child care centres in local government situations).

Assets such as schools and hospitals can become surplus in particular circumstances and therefore the land can become available for feasible alternative uses. Generally it would be supported by a government decision that the asset is surplus. Therefore, the highest and best use of the land and improvements are assessed together. In these circumstances, an entity must consider whether the item meets the definition of an asset held for sale. However, for most land under schools, hospitals and fire stations, there is no alternative use, because the entity is mandated to continue to provide the community service obligations and the services are needed at that location. The same could apply to some local government child care centres, community centres, etc.

Regarding reliable measurement, current market prices (whether measured at highest and best use or existing use) usually can be observed for land (AASB 116 paragraph 32). They can also be derived from observable market evidence, for example observable current market rentals for leased land.

Some general guidelines for the valuation of specific types of land assets including parks and reserves, land under general and specialised buildings, and land under specialised plant, infrastructure and heritage assets are set out in the examples section.

The valuation of restricted local government assets such as parklands and heritage assets is based on the highest and best use of the asset after due consideration is made for any legal or other restrictions imposed on the asset.

In summary, valuers should consider the following in assessing values of parklands and reserves for financial reporting purposes:

1. Direct comparison with sales of reserves, parkland or land that has the same restriction in use.
2. Comparison of values to sales of surrounding properties to establish possible discount rates.
3. Bear in mind case law such as Road Construction Authority and City of Brighton (Dendy Park case) in so far as they relate to providing evidence or an indication of discounting for restricted use.
4. Municipal valuers should be prepared to share information they have concerning "restricted use" land sales with other municipal valuers so that all involved are using a standard and correct approach.

3.2. Valuation of buildings

In all cases, buildings and the land on which they are built must be considered together in determining whether feasible alternative uses exist. Consideration should be made of the fact that land and buildings are to be considered as separate asset classes for the purposes of financial reporting valuations and that entities may be required to report the value of land at one period and the value of buildings at a separate time.

AASB 116 and the accompanying Australian Guidance to the standard, discuss the types of market-based evidence for property, plant and equipment. Both the standard and the guidance notes acknowledge that there are specialised and non-specialised assets (AASB 116 paragraph 33 and AASB 116 Australian Guidance paragraphs G3 and G4).

3.2.1. Non-specialised buildings

Non-specialised buildings include commercial and general-purpose buildings for which there is a secondary market. Non-specialised property is to be valued at fair value having regard to highest and best use. The buildings and the land under the buildings are to be valued consistently.

Fair value, based on current market prices, can usually be observed for land and non-specialised buildings (AASB 116 Australian Guidance paragraph G3). However in the absence of observable market prices, the Australian Guidance to AASB 116 explicitly notes that current market prices can also "be derived from observable market evidence (eg observable current market rentals) using discounted cash flow analysis" (AASB 116 Australian Guidance paragraph G3). This is an application of the income approach allowed under AASB 116, paragraph 33. The use of market-based evidence is in accordance with AASB 116.

3.2.2. Specialised buildings

Specialised buildings are buildings designed for a specific limited purpose. In the state government sector these buildings include hospitals, schools, courthouses, emergency services buildings (police, fire, ambulance etc), specialised buildings to house specialised infrastructure or plant and some heritage/historic properties.

In most cases, these specialised buildings and the land under them have no feasible alternative use because the entity is mandated to continue to provide the goods or services or community obligations that the building permits. Further, where a building is specialised, there may be no observable market evidence of its market-selling price. However, there are exceptions to this where the services can be moved to another location or are no longer required, either for strategic reasons or because of demographic changes.

Where there is no available market-based evidence, specialised buildings are to be valued at market buying prices, the best indicator of which is the replacement cost of the asset's remaining economic benefits (DRC approach).

Professional judgment about the distinction between specialised and non-specialised buildings is therefore required. The valuation of specialised plant and infrastructure must be adjusted for permanent excess capacity. However for some specialised buildings, there may be excess capacity, for example, excess capacity in a hospital may be able to be leased out to another entity for medical-related services.

In a local government context a council may be able to lease out excess capacity in a shire or city office centre. However, it would need to be demonstrated that a feasible alternative use exists. In these demonstrated cases, the excess may not be permanent excess capacity.

3.3. Valuation of specialised plant and infrastructure

The best way to measure the fair value of specialised plant and infrastructure assets is to determine a market buying price, the best indicator of which is the depreciated replacement cost. This is arrived at first by determining the gross cost of replacing the full service potential of the existing asset, then adjusting this cost to take account of the expired service potential of the asset.

Gross replacement cost is not necessarily the cost of replicating the asset (reproduction cost). Replacement cost is *"measured by reference to the lowest cost at which the gross future economic benefits of that asset could currently be obtained in the normal course of business"* (AASB 136, paragraph Aus 32.2).

The use of gross replacement cost as a basis of measurement first requires an adjustment to the existing asset for any excess capacity, over design ("gold plating") or redundancy. The concept of the "modern equivalent asset" is adopted to cater for such adjustments.

3.3.1. Modern equivalent asset (MEA)

Where existing assets are over designed, have excess capacity, or are redundant an adjustment needs to be made so that the resulting valuation reflects the cost of replacing the existing economic benefits based on an efficient set of modern equivalent assets to achieve the required level of service output within the agency's planning horizon.

Permanent excess capacity, and any redundant assets or components that are not severable should have no value assigned to them. Redundant assets that are severable from the network should be valued at market selling price, less costs to sell. Over designed "gold plated" assets have features that are not required for the services they provide. These features will not be included in the replacement cost of a modern equivalent asset.

While the cost of the MEA is a surrogate for the current cost of an asset held, it does not mean that the MEA will be acquired as a replacement in the future.

The MEA could have different quality, capacity, configuration or even useful life to the asset being valued. In these cases the replacement cost of the MEA must be pro-rated to the economic benefits of the existing asset. This asset should not exceed the anticipated needs as realistically determined by the entity. This is termed "expected capacity in use".

3.3.2. Use of "greenfield" assumption

The gross replacement cost of an asset must be determined for each component of the asset, notwithstanding that certain components may not actually need to be replaced (such as road earthworks).

The unit rates (labour and materials) and quantities applied to determine the replacement cost of a component must be based on a "greenfield" assumption. The replacement cost, as determined under this assumption, may differ from the actual treatment cost when a component is replaced, for example due to the reuse of *in situ* materials.

3.3.3. Written down replacement cost

The carrying amount of a depreciable asset must reflect the remaining economic benefits of the asset. Thus the gross replacement cost of the MEA is reduced to exclude the economic benefits already consumed or expired for the current asset.

3.3.4. Depreciation

AASB 116 (paragraph 43 to 62) provides detailed commentary on depreciation. All valuers should first attempt to relate depreciation amounts and rates to market evidence. The use of percentage depreciation rates or standard formulae is only acceptable when market evidence is not available. Professional judgement will always be required to relate depreciation to market evidence especially when there is limited market evidence available and the DRC approach is being used.

Valuers need to be able to quantify the impacts of depreciation when valuing assets using the DRC approach. When using the capitalisation or income approach, depreciation is automatically taken into account through the income applied.

3.3.5. Useful life

AASB 116 (paragraph 50) discusses the concept of an asset's "useful life". Valuers need to be aware of this so they can allocate an age and "remaining useful life" to each asset valued for recording purposes.

Paragraph 56 of AASB116 refers to determining useful life of an asset and notes that the following should be considered:

- (a) expected use of the asset
- (b) expected physical wear and tear
- (c) technical or commercial obsolescence
- (d) legal or similar limits on the use of the asset.

Consideration should also be taken of any other factors that will affect the useful life of the asset such as:

- (a) the maintenance expected to be provided to the asset
- (b) the quality of the original asset
- (c) the environment in which the asset is operated or constructed

Further details are provided in "Reference to DVC's Accounting for Infrastructure Assets 2003".

3.4. Valuation of cash-generating units

It is expected that local governments will have few if any assets that are regarded as being or being part of "cash-generating (or generation) units (or operations)". For guidance on what constitutes a cash-generating unit it is suggested that the explanations in AASB 136 (paragraphs 66–73) be considered.

The judgement that must be made to identify a cash-generating unit involves considering various factors including how management monitors the entity's operations (such as product lines, businesses, individual locations, districts or regional areas) or how management makes decisions about continuing or disposing of the entity's assets and operations (refer to AASB 116 paragraph 69).

Most of the state's non-current physical assets are in the non-cash generating class and the same can be said for local government assets. The valuer needs to discuss possible cash-generating assets with the instructing party. Generally a state or local government sector asset used for a community service will not show a relationship between income and value as could be expected from a fully functioning private sector asset set up to produce "cash". Even when an asset produces some "cash" or "turnover" because the public pays entry fees for example, the turnover or income is insufficient to have a proper relationship with a market value derived by the income or discounted cash flow (DCF) valuation model. Therefore, as per the decision tree on page 10, in most of these cases, the asset should be valued using the DRC approach.

3.5. Valuation of heritage/cultural assets

There will be many non-current physical assets in the local government sector that will be regarded as "heritage" or "cultural" assets. Those carrying out financial reporting valuations will have to decide on whether to use "replacement" cost or "reproduction" cost estimates when determining a starting point for the DRC approach or even when assessing an insurance value.

3.6. Valuation of assets held for sale

Assets held for sale is a separate asset class subject to a separate accounting standard – AASB 5. There are specific criteria in that standard that must be satisfied for assets to be classified as held for sale. Any assets that satisfy the criteria must be valued at fair value less costs to sell, where this value is lower than the current carrying amount. The fair value arrived at will be a market value based on prevailing market terms and conditions as at the date of valuation.

Surplus assets that do not satisfy the criteria to be classified as "held for sale" but which may be sold in the future, must continue to be valued on the same basis as the other non-current assets in the class to which it belongs.

4. Revaluation frequency

AASB 116 gives reporting entities some guidance in deciding when to revalue. *“An entity assesses at each reporting date whether there is any indication that a revalued asset’s carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the entity determines the asset’s fair value and revalues the asset to that amount.”* (AASB 116 Australian Guidance paragraph G6)

However, this does not help accounting staff or valuers complete their tasks. There needs to be a decision made prior to the reporting dates about whether there has been a material change in values or not. The timing should be made so that there is sufficient time to carry out a full revaluation if it is required.

Local government valuations for land and buildings rating purposes occur every two years in Victoria and it is sensible to incorporate council asset revaluations into the municipal program using either in-house or contracted valuers to carry out the work. It would be in the best interests of all concerned for local government to adopt a policy of revaluation every two years without the need for a full revaluation in between.

4.1. Indexation

While indexation should never be used as a complete substitute for revaluations, it can be used as a cost-effective way to decide whether there has been a material change in values over time. If a marked change (say 10 per cent or more) is apparent then revaluation should be undertaken.

Index factors should be based on the price movement of land used for similar purposes as the land being valued. If councils do not have suitably qualified people or systems to determine index factors they can contact Valuer-General Victoria who can supply index factors for land on a postcode basis suitable for the task. The factors will only cover the expected movement in land values for particular asset use types, simply because index factors for land and buildings (together as one factor) for state and local government asset types are too difficult to accurately formulate. Past experience has shown that indexing land and buildings together in the one factor can distort the overall outcome. In general terms land tends to appreciate over time while buildings tend to depreciate. The use of CPI or other index factors not specifically related to non-current physical assets should be avoided as the increase or decrease in values may not reflect the true situation.

Under AASB 116 (paragraph 58) land and buildings are separable assets and are accounted for separately. The standard notes that with few exceptions land has an unlimited useful life and therefore is not depreciated. It also states that *“An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.”*

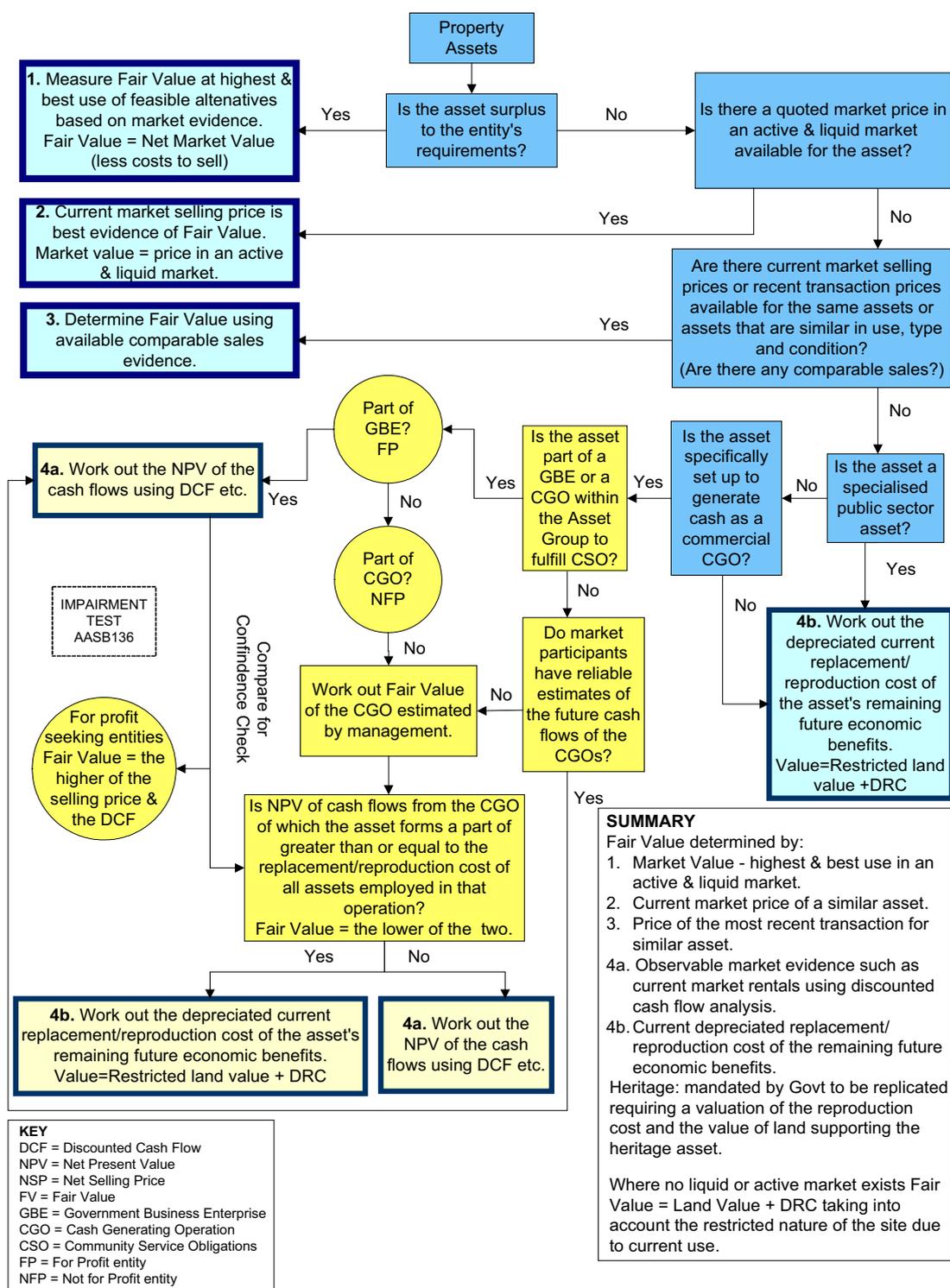
The practice of using index factors to test for a material change is a cost-effective method especially for large numbers of similar type assets. However, the actual revaluation of a council's property, plant and equipment assets by using index factors should be avoided if this methodology is used for more than two years. Because of the averaging effect, valuation amounts that have had more than two years of indexation applied will not represent true “fair value” assessments for financial reporting.

In a local government context, revaluations of assets scheduled to coincide with municipal revaluations would appear to be a sensible process. The relevant date could, in fact, be the same January date as the revaluation but the financial reporting valuation needs to reflect the position for the respective financial year. The choice of the relevant date for financial reporting purposes is not the valuers to make.

5. Fair value decision tree

Australian state and territory Valuers-General have agreed for some time about the process involved in deciding the method to use for financial reporting in the government sector. A simplified high-level decision tree has evolved and is reproduced here for local government guidance. It may not cover all situations and should be viewed as a guide only. The decision tree does not necessarily apply to non-current assets classified as investment properties, assets held for sale or inventories.

VALUERS-GENERAL FAIR VALUE DECISION TREE FOR NON-CURRENT PHYSICAL ASSETS IN THE PUBLIC SECTOR 2006 Guidance to valuers in carrying out valuations to satisfy AASB116



6. Examples of local government assets and the methods of valuation

6.1. Council land used for parks, recreation areas, and open space

This land will generally be restricted for use by the community as passive recreation for example. While areas of this type of land occasionally come up for sale in the open market, the frequency of sales evidence does not necessarily make this an active and liquid market.

The land is generally restricted in a number of ways and its use is far from its underlying highest and best use. In terms of the land's community service obligations the current use could be regarded as being its highest and best use. On this basis, and assuming there is no active and liquid market, the valuer needs to consider the sales evidence from comparable sales (as much as possible) but apply discount factors for the restrictions in use for that type of land. The extent of the restrictions will vary depending on circumstances.

It is not suggested here that valuers adopt a "scale of discount factors" because that limits the valuer's ability to properly assess the extent of the restriction. However, certain "use restrictions" on land will give rise to a range of "discount" factors. Investigation work is being done in this area by Valuers-General in Australia to establish some benchmarks for discounts. The results of this work will be made available to valuers in the future.

If sales evidence of creek frontage land, low lying land, open space land or easement affected land can be found then this evidence should be used to assist the valuer to determine the fair value of lands with similar service potential. Once those valuers engaged in the valuation of local government property assets for financial reporting are able to determine an active and liquid market exists through based evidence, this type of information should be shared to provide uniformity across the local government sector.

6.2. Municipal offices

The valuation of municipal offices will not necessarily be the same in each local council. If municipal offices are of a specialised nature, or heritage-listed, then a restricted land value plus DRC will apply. If separate parts of the complex are leased out for uses other than municipal purposes (over capacity) then consideration needs to be given to income streams and the capitalisation or net present value (NPV) approach applied. However the common method applied would be expected to be the DRC approach.

6.3. Libraries

Unless there is market evidence of similar type property (unlikely), then municipal libraries would generally be expected to be valued using the DRC approach.

6.4. Sports pavilions, football grounds, basketball centres, tennis courts, bowling greens and swimming pool complexes

These will be all specialised community assets in their own way with little in the way of "active and liquid" market sales evidence to rely on. In most cases the method will be a fair value for the land taking into account the restrictive nature of the use, but based on as similar as possible land sales evidence available. Generally the buildings and structures will be valued using the DRC approach.

6.5. Day care centres, kindergartens and pre-school centres

In a number of cases there may be some form of "active and liquid" market for this type of asset. The market may provide some evidence for allocating values. However, allowances will need to be made for the fact that these assets provide a community service obligation while in the ownership of the council and would not generally be for "profitable" purposes. The restrictive situation of the ownership and use needs to be taken into account and it would be expected that values would be less than those applied to private sector, profit-seeking versions of these centres.

Generally, a restricted use land value plus DRC approach for the buildings would be expected to be the valuation method.

6.6. Information centres, halls, scout halls, guide halls and community centres

Generally specialised in nature with few or no sales to go by, these assets would usually be valued using a land value based on underlying zoning values in the area, but subject to restricted use constraints along with a DRC approach for the buildings.

6.7. Aged care complexes

These specialised assets do occur in the open market and there can be an inferred “active and liquid” market at times. Consideration needs to be given to where the centre is located, how many there are in the area or municipality, sales evidence of similar types of property and any special restrictions that might apply to the centre.

6.8. Tourist ventures – for example, cheese factory

Depending on the circumstances applicable to the council ownership these ventures could be so specialised as to have no comparable sales evidence at all. However, if there is a relevant “active and liquid” market place for this type of venture then DCF, NPV or capitalisation approaches are applicable. In most cases it would be expected that a land figure plus DRC approach would apply.

6.9. Dwellings

In general, dwellings that are used as such and could be readily sold in the residential market would be valued on a direct comparison market value approach based on sales evidence. There will be situations however where dwellings are just part of a much bigger complex and may be surplus to requirements. In some cases the dwellings will add little or no value if the land underneath is destined for other uses in the near future. Only councils will know these facts and will need to be consulted. A DRC approach for the building would be applicable if the use is continuing as a dwelling but the land is part of a bigger development and it would not be feasible to take out a separate curtilage.

6.10. Picnic facilities – including picnic tables, barbeques, etc

In general terms these are to be valued using the DRC approach but taking into account the MEA method.

6.11. Other site improvements

Other site improvements include assets such as fencing, paving, car parking (asphalt, concrete, crushed rock etc), landscaping, water features, dams, ponds, levelling, etc. These are best valued by the DRC approach provided that reasonable cost estimates are available to start with.

7. Conclusion

These guidelines are an introduction to some of the methods associated with valuing non-current physical assets for financial reporting in the Victorian local government sector. They do not attempt to cover all aspects of the subject. For a more detailed explanation, valuers and others should read and understand the concepts from AASB 116.

Municipal valuers and those in councils contracting out valuation services are reminded to read the Valuation Best Practice Specification Guidelines 2006 (pages 78–79) provided by Valuer-General Victoria to councils, regarding "Asset Valuations for Financial Reporting". Please note that the reference to AASB 1041 and AAS27 should now refer to just AASB 116.

For information on asset valuations for financial reporting purposes for government property transactions, please refer to the Valuer-General Victoria website – <http://www.land.vic.gov.au/valuation>, click on "Valuations for Government Property Transactions", then "Asset Valuations for Government".

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