Queensland Government

Queensland Treasury
Non-Current Asset Policies for the Queensland Public Sector

NCAP 3 Valuation of Non-Current Assets

OVERVIEW

This Non-Current Asset Policy (NCAP) discusses the principles underlying the valuation of non-current assets.

TABLE OF CONTENTS

3.1. INTRODUCTION

The *Framework for the Preparation and Presentation of Financial Statements* (the Framework) describes the fundamental characteristics that make the information provided in financial reports useful to users as *relevance* and *faithful representation*. This policy takes the position that, for the most part, the characteristics of *relevance* and *faithful representation* will be met by valuing non-current physical assets at their fair value, as defined in AASB 13 *Fair Value Measurement* rather than at cost.

AASB 13 outlines how to measure fair value when fair value measurement is permitted or required by other Australian accounting standards, subject to Queensland Treasury policies for departments and statutory bodies. This chapter provides additional guidance and examples to help agencies apply such requirements. All such guidance and examples must be read in conjunction with AASB 13.

3.2. APPLICATION OF COST BASIS

As set out in Appendix 1.1 of NCAP 1, it is Queensland Treasury policy that the following assets are to be subsequently measured using the cost model:

- **plant and equipment, other than major plant and equipment;**
- **work in progress; and**
- **intangible assets for which there is no active market.**

While all property, plant and equipment are generally to be recorded at fair value, assets belonging to the class plant and equipment will usually have relatively short useful lives to the entity, and fair values will not differ significantly from its written down value. On this basis agencies are to record plant and equipment at cost, in lieu of fair value. Assets measured at cost are never to be revalued. The annual review of estimated useful life should ensure the assets are not fully depreciated while they retain some service potential. Even after being fully depreciated, assets carried at cost cannot be revalued.

3.3. APPLICATION OF FAIR VALUE BASIS

As set out in Appendix 1.1 of NCAP 1, it is Queensland Treasury policy that, subject to the exception below, the following asset are to be subsequently measured using the revaluation model:

- **land;**
- **buildings;**

- **infrastructure;**
- **major plant and equipment;**
- **library reference collections;**
- **heritage and cultural assets;**
- **intangible assets that have an active market; and**
- **investment property, including investment property under construction (except where fair value cannot be measured reliably – see AASB 140 paragraph 53).**

***Exception: For-profit* statutory bodies and agencies *not consolidated* into the whole-of-Government financial statements have the discretion to measure property, plant and equipment and investment property at fair value or cost.** Any change in measurement policy must facilitate the financial statements providing reliable and more relevant information (as per AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 14(b)). If an agency changes its asset measurement policy, it must comply with AASB 108, including the requirement for retrospective application.

Where a for-profit statutory body consolidated into the whole-of-Government financial statements chooses the cost model, it must provide supplementary fair value information to Queensland Treasury to ensure the reported asset values materially reflect fair value in the whole-of-Government financial statements.

3.4. APPLICATION OF FAIR VALUE CONCEPTS

The term 'fair value' is defined in AASB 13 as being *"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."*

The 'fair value' concept in AASB 13, and the fair value guidance throughout the Non-Current Asset Policies, reflect an 'exit price' approach. Appendix 3.1 Determination of Fair Value Hierarchy Level sets out the process for identifying the fair value inputs and corresponding fair value hierarchy levels. 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;
- which market a sale of that asset would take place in;
- who would buy the asset and what they would take into account;
- 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, see AASB 13).

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

3.4.1. Market and market participants

Fair value measurement assumes that the transactions are taking place in either the principal market or, in the absence of a principal market, the most advantageous market for the asset. The agency must have access to the relevant (i.e. either the principal or the most advantageous) market at the measurement date. The concepts of principal market and most advantageous market are defined and explained in AASB 13.

There may be situations where specific markets and/or market participants are not readily apparent. In such circumstances, agencies should approach this by considering:

- what the asset can be used for;
- who would use it for those purposes; and
- what would those parties take into account in determining a price to pay for the asset.

Valuers are generally in the best position to determine these, in consultation with agencies. Agencies are responsible for assessing whether the valuer's assumptions are reasonable, relevant and complete because when those assumptions are used by management, they become management's assumptions. As per the definition, fair value is not an entity specific value; it is based on a market participant's perspective, assuming they act in their economic best interest. The term "market participants" is defined in Appendix A of AASB 13.

Some specialised assets are rarely if ever sold and there are no identifiable market participants or observable market data. For such assets, the agency assumes the existence of a hypothetical market participant buyer who steps into the shoes of the agency in determining how much it would pay to acquire the asset, and accordingly the amount the agency would receive in a hypothetical sale.

Appendix F of AASB 13 explains that various non-financial assets of not-for-profit public sector entities not held primarily for generating cash flows do not have observable market data because they are seldom sold. Where the market selling price of a comparable asset and market participant data required to measure fair value are not observable, the agency shall use its own assumptions as a starting point and adjust those assumptions where reasonably available information indicates that other market participants would use different data. Exhaustive efforts need not be

undertaken to identify information about potentially different market participant assumptions, but where such information is reasonably available, it cannot be ignored.

3.4.2. Highest and best use

Under AASB 13, the fair value of a non-financial asset is determined by reference to its "highest and best use". However, in respect of assets of not-for-profit agencies that are not held primarily for generation of cash flows:

- The asset's current use is presumed to be its highest and best use unless the asset is classified as held for sale (under AASB 5) or it becomes highly probable that the asset will be used for an alternative purpose. Agencies are only required to consider whether the asset's highest and best use differs from its current use when this assumption is rebutted, and should refer to AASB 13 para Aus29.2 and the asset held for sale criteria in AASB 5 when assessing whether this presumption is rebutted for a particular asset or assets.

- 'Financially feasible' for these non-cash-generating assets refers to whether market participants (including not-for-profit government agencies) would be willing to invest in the asset's service capacity, considering both the capability of the asset to be used to provide needed goods or services and the resulting cost of those goods or services.

Due to the requirements of AASB 13 para Aus29.1, it is expected that the majority of non-cash-generating assets held by not-for-profit agencies would have a highest and best use that's the same as their current use.

For-profit agencies need to be aware that the highest and best use of an asset should be determined from the perspective of market participants, regardless of how the asset is currently used or the agency's present intentions or preferences. There may be evidence suggesting that a different (highest and best) use would maximise the economic benefits of the asset and that use is legally permissible, financially feasible and physically possible.

3.4.3. Fair value hierarchy

It is Queensland Treasury policy that where an agency has an asset that it believes should be categorised differently to what is suggested in Appendix 3.2, that agency should consult with Queensland Treasury (via FMC Support) stating their preferred categorisation and justification for that.

Agencies should refer to Appendix 3.2 for the fair value level Queensland Treasury recommends for various types of assets, for consistency across agencies.

Regardless of which valuation technique is used (refer to the heading 'Valuation approaches' under NCAP 3.5 Valuation Approaches), the data inputs used for the calculation (and the resulting fair value) must be categorised into one of the three levels of the fair value hierarchy described in AASB 13 – refer to paragraphs 72 – 90 of AASB 13. Appendix 3.1 depicts how this hierarchy applies in light of valuation inputs, and how agencies should approach the valuation of assets.

The term "quoted" means there are publicly available prices for a particular item in a market. In contrast, the term "observable" is broader than "quoted" and encompasses other publicly available data which, in some cases, may only be accessible via a subscription service.

Examples of "observable" data would include prices for past property sales, advertised rental rates, reputable lists of recommended selling prices for particular items, published indices, published interest rates and yield curves etc. Examples of "unobservable" data would include past transaction prices between an entity and a supplier (where such prices are not advertised publicly), an entity's own historical data on costs incurred, and the subjective judgements applied in determining fair values.

The term "identical" is to be interpreted as meaning having exactly the same physical, financial and legal characteristics.

In measuring fair value, highest priority is given to quoted prices in active markets for identical assets and lowest priority is given to unobservable inputs. In light of this, determining fair value with reference to values of identical assets would be rare for non-current physical assets. Therefore, it is unlikely that any agency non-current physical assets would have level 1 fair values.

Valuation inputs that are observable are more reliable than inputs that are unobservable, as often unobservable inputs are derived by an entity rather than reflecting market evidence. Observable inputs used must be relevant, reliable, verifiable and appropriate to the asset's circumstances. In using observable data, agencies should identify the recency of such data, to judge its relevance to fair value, and the extent to which any adjustment needs to be made in using it.

Where the use of level 2 inputs alone does not materially reflect the fair value of an asset, an adjustment to level 2 inputs may be required. An adjustment of a level 2 input using unobservable inputs that are significant to the entire fair value measurement may result in the entire fair value measurement being categorised as level 3.

The word "significant" is not defined in AASB 13, so agencies should use normal materiality guidance to judge significance. Also refer to NCAP 3.5 Valuation Approaches and NCAP 3.6 Revaluation Methods and Frequency.

Subject to that, agencies should have a documented accounting policy about how they determine the significance of adjustments to observable inputs using unobservable data, and apply that policy consistently. A reasonable starting point to determine the effect of any adjustments using unobservable data on the resulting fair value would be to:

- determine the overall fair value;
- attempt to determine a fair value based only on the observable inputs (if practicable); and
- identify the numerical difference between those two values.

Agencies should ensure they have given appropriate consideration to the existence of available observable inputs. Even in an inactive market, it should not automatically be presumed that the transactions do not represent fair value, or that the market is not orderly. Agencies will need to consider the relevant facts and circumstances in making their judgements.

In some instances, however, there will be no observable inputs available. This is expected to be the case for specialised assets such as infrastructure (e.g. roads, harbours and dams) and specialised buildings such as hospitals and prisons. In those situations, agencies must use unobservable inputs to the extent that relevant observable inputs are not available. Like the use of observable inputs, the unobservable inputs used must reflect the assumptions market participants would use when pricing the asset. An example of unobservable data is internal data on past construction costs for a particular asset. Regardless of whether or not an external party has been engaged, agencies must review and understand the inputs and other assumptions used in valuations to determine the appropriate categorisation of the overall fair value measurement in the fair value hierarchy.

For assets that have not yet been revalued by specific appraisal (due to either purchase or construction), the fair value level should reflect the fair value level for similar assets within the same class, taking into account the recommendations in Appendix 3.2.

NCAP Tools Illustrative Examples 3.4.1 to 3.4.11 provides examples that demonstrate the application of the fair value hierarchy for different types of assets.

Transfers between levels

From year to year, agencies must review the fair value levels assigned to their assets in light of changed asset characteristics (e.g. age, condition etc.), changes in market conditions and/or valuation techniques and changes in the nature/quality and significance of data inputs used in determining fair value.

If, as an outcome of this review, an agency believes the fair value level for any assets should be different to what is recommended in Appendix 3.2 for the particular type of asset, they are to consult with Queensland Treasury (via FMC Support).

Transfers of asset values between fair value levels are otherwise expected by Queensland Treasury to be rare. Any necessary transfers of asset values between fair value levels are to take effect in conjunction with the recognition of the associated revaluations.

3.5. VALUATION APPROACHES

Appendix 3.1 demonstrates how agencies are to approach valuations under AASB 13. In the absence of quoted prices for an identical asset, fair values are to be determined using valuation techniques that are appropriate in the circumstances and for which sufficient data is available. Valuation techniques used to calculate fair value fall into either the *market approach*, the *income approach* or the *cost approach*. Each of these approaches is defined in AASB 13, and further explained in paragraphs B5 – B30.

No matter which valuation technique is used, the aim is to determine a fair value that a market participant would place on the asset. This should be achieved by using a valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Agencies should therefore strive to use a valuation technique that is relevant and reflects the characteristics and assumptions about the asset and uses data inputs that are as observable as possible, provided sufficient reliable data can be obtained for that technique, and the data is relevant to the asset being valued. Even where fair values are determined by external parties, agencies must assess whether, and be satisfied that, the techniques and methodologies used are reasonable, relevant and complete.

Once a valuation technique has been selected, it should be applied consistently to assets within that class. For example, the fair value of buildings may be able to be derived from observable market-based information, in which case that approach would generally be appropriate for all assets in that class.

A change in valuation technique is only appropriate if the change would result in a measurement that is equally or more representative of fair value in the circumstances. Any such change would need to be accounted for as a change in accounting estimate in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. Appendix 3.2 provides guidance on the expected valuation approaches and expected fair value hierarchy categorisation for various types of non-current physical assets.

3.5.1. 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.

Land zoned for public service purposes that are non-cash-generating

Certain land held by agencies may be zoned for public service purposes – such as land under roads, hospitals, schools, and prisons. These types of properties used for public services are rarely sold "as is" in the market. For land with such public service zoning restrictions that are not held primarily to generate cash flows:

A not-for-profit agency is to assume that the property's current use (e.g. as a hospital, school, etc) is it highest and best use unless it is highly probable that it will be used for an alternative purpose – see AASB 13 para Aus29.1.

The market and cost approaches are likely to result in similar fair values for the land, because if the agency needs to replace the service capacity of the land, it will typically need to acquire land on the market (since land cannot be 'constructed' like buildings or infrastructure). This may not be the case for land raised from below sea level.

The market price of nearby freehold land should be a reliable indicator of the fair value of the land. Agencies should only adjust the market price of freehold land for zoning restrictions (e.g. the land's zoning as a road corridor, hospital site, etc) if there is recent market evidence from sales of land with a similar zoning restriction in the nearby region to support the adjustment. Arbitrary discounts for land zoning restrictions that are not supported by recent market sales evidence should not be applied.

The fair value of the land should also be adjusted for physical properties or restrictions that makes it different from nearby freehold land, where such features would be passed on to a market participant buyer, including for example:

- the land's location, elevation and topography;
- other positive features such as if the land contains particular earthworks that makes it fit for purpose for its current use; and
- other negative features such as if the land is contaminated or legally requires rehabilitation, or it was used as a cemetery and may have human remains buried within.

3.5.2. Income approach

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. Paragraphs B12 – B30 of AASB 13 contain guidance on the application of present value techniques.

When using the DCF technique to determine fair value, agencies should develop a (post-valuation) quality assurance framework to ensure the validity and reliability of the asset values determined under this approach. Agencies should consider obtaining external, independent, expert advice in the development of this framework. The quality assurance framework should address such issues as (but not be limited to) the following:

- regular testing of the assumptions used in the cash flow model against actual outcomes in subsequent periods, and;
- ensuring the cash flow model is based on reasonable and supportable assumptions which have been founded on objective evidence and rational judgement.

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. In applying the DCF technique, agencies must have regard to the guidance contained in Appendix A of AASB 136 *Impairment of Assets,* subject to fair value principles, including the following key consideration points:

- Subject to data availability for the asset(s) being measured, the timeframe for cash flows should be five years unless cash flows for a longer period can be reliably determined. Cash flows beyond five years should be extrapolated at a steady or declining growth rate.

- Cash flows estimates should be consistent with the principle of highest and best use, reflecting market participants' assumptions about future performance and potential of the asset. Regard should be had to past evidence of actual cash flows, to test the reasonableness of future cash flow estimates.

- Estimates of future cash flows include projections: cash inflows from the continuing use of the asset(s); cash outflows that are necessarily incurred to generate cash inflows from continuing use of the asset(s); and net cash flows (if any) to be received/paid for the disposal of the asset(s) at the end of their useful life.

- Estimated future cash flows arising from entity specific circumstances, such as future restructuring to which an entity is not yet committed, or improving or enhancing the assets' performance (as opposed to maintenance and planned capital expenditure), are not to be included in the estimates of future cash flows unless evidence suggests that a market participant would take these factors into account.

- A disposal cash flow/terminal value for the asset(s) or cash generating unit (whether or not they have an indefinite useful life) should be included in the calculation i.e. the expected cash flows, adjusted for future price changes, that will be realised on scrapping or selling the asset(s) at the end of the discrete period for which the cash flow projections are prepared.

- The discount rate should reflect characteristics of the asset being measured, the likely rate a market participant would use, and assumptions inherent in the cash flows (e.g. the risks specific to the asset for which the future cash flow estimates have not been adjusted, and the time value of money – AASB 136 para 55). The discount rate used must be reasonable and supportable. Where an agency does not have its own specialised financial expertise for this purpose, it is strongly encouraged to seek advice from an appropriately skilled external party, such as Queensland Treasury Corporation's Treasury Services Team.

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 an agency 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 the

agency. 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.

Agencies must disclose in the notes to the financial statements all significant assumptions underpinning the results of the DCF calculations in accordance with disclosure requirements contained in AASB 13 and AASB 101 *Presentation of Financial Statements*. Also refer to the heading 'Valuation of Asset Groups or Complex Assets' under NCAP 3.10 Specific Valuation Issues.

Existence of a Regulated Asset Base

For financial reporting purposes, it is Queensland Treasury policy that the value of the RAB, as assessed by the regulator, is not to be assumed by an agency to be the measure of fair value for the asset group. However, agencies 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.

A number of Queensland public sector agencies operate in a price-regulated industry, such as those operating in the water and electricity 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 public sector 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) and is defined as *"the 'market value' of the business based on its potential to earn revenue under existing Regulatory arrangements*."

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).

In some instances, the regulator allows inclusion of costs in the RAB value that are not allowed for inclusion in the value of an asset under AASB 116, for example, indirect overheads.

When using a DCF technique for determining the fair value of regulated assets, management should consider the following points:

- the reliability of inputs and assumptions used to calculate the RAB i.e. are these the assumptions and inputs that a market participant is likely to use to value the asset?;

- the appropriateness of RAB valuation inputs in relation to capitalisation requirements under AASB 116. Adjustments to the cash flows used by the regulator to determine RAB may be necessary where the estimated cash flows generated by the CGU/assets do not include the expenditure necessary to maintain the performance of the existing assets i.e. replacement of components of the CGU/assets assuming their replacement is required to maintain the performance of the CGU as a whole. The inclusions of such additional expenditure should be evidenced by the entity's asset management plan and or capital expenditure budgets etc;

- the appropriate discount rate to use (assessed annually), for example the Weighted Average Cost of Capital (WACC) approach used by the regulator based on extensive industry participation consultation may be used with adjustments made for market participant assumptions regarding risk, gearing, imputation credits and cost of debt, if appropriate;

- whether the set regulatory period (e.g. five years) is the appropriate period for discounting cash flows;

- the relevance of using CPI to inflate cash flows - even though this is the factor generally used by the regulator;

- a terminal value (i.e. expected net cash flows that will be realised on scrapping or selling the CGU/assets at the end of their useful life) may need to be included in the DCF

calculation due to the longevity of public sector infrastructure assets. It will be necessary to demonstrate that the value used is relevant and reliable for the assets being valued. In this instance, the RAB value may not always be appropriate. Inclusion of a terminal value for the asset, e.g. a terminal value based on the RAB, would be reasonable notwithstanding that the form of future regulation is uncertain given that a market participant is in the same position;

- use cash flows generated from the smallest identifiable group of assets that produce the cash inflows;

- a post-tax discount rate should be used as this reflects what market participants would use; and

- the cash flows should include modelling of cash flows arising from the Goods and Services Tax (GST).

3.5.3. Cost approach

Current replacement cost (CRC) is the most common valuation technique under the cost approach. CRC reflects the cost to acquire the service potential embodied in an asset, adjusted to reflect the asset's present condition/physical deterioration, functionality (technological) obsolescence and 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 the useful life of the asset also results in a revaluation adjustment, to reflect a straight line depreciation profile over the asset's new useful life. Sufficient knowledge of the asset circumstances is required in order to properly assess the asset's remaining service potential and physical/economic/functional obsolescence.

Under AASB 13, CRC for a subject asset is determined by calculating an equivalent 'reference asset', which typically occurs 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 – see *NCAP Tools Illustrative Example 3.5.1*; or

- as the cost of reproducing or replicating the future service potential of the asset itself.

The application of CRC 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 at the subject asset's existing location. In most cases, public sector assets measured using CRC are not held for generating cash flows and do not have observable market selling prices.

As such, in accordance with AASB 13 paragraphs F5 and F11(b), then agency uses its own assumptions as a starting point when developing unobservable inputs to measure the replacement costs, and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

Where an agency has records of actual construction costs for a new asset, those costs are relevant to the asset being valued, and the agency is confident there is no significant change in those costs between the date of completion and date of valuation, those actual cost of construction may be used as an appropriate starting point for CRC.

When estimating the replacement cost of an asset, agencies should refer to AASB 13 paragraphs F11 to F15, which provide guidance regarding -

- costs of restoring another entity's asset that would be disturbed when replacing the asset – *see NCAP Tools Illustrative Example 3.5.2;*
- other disruption costs, such as redirecting traffic;
- site preparation costs, such as earthworks and disposal of unwanted existing structures – *see NCAP Tools Illustrative Example 3.5.3*;
- costs to replicate heritage assets.

Particular attention is drawn to paragraph F12(c) of AASB 13 which provides specific guidance on avoiding double counting of site preparation costs for a reference land asset where the subject asset's land parcel is already fit-for-purpose for the subject asset and the subject asset's fair value already takes this fact into account.

Further commentary is found in paragraphs BC171 to BC 173 in the AASB 2022-10 Basis of Conclusion.

Where the valuer determines that site preparation costs for a reference asset should be included, the valuation report should explicitly say why the fair value of subject asset's land parcel does not already take these in account.

Indicators of Change in an Asset's Service Potential/Capacity

Indicators of a reduction in future service potential/capacity in the public sector include: physical deterioration, functional (technological) obsolescence and economic obsolescence.

As part of the annual revaluation process for such assets, agencies are to have a framework in place to ensure that any changes in an asset's service capacity are identified and reflected in an agency's annual valuation process (see also NCAP 3.5 on indicators of change in an asset's service potential/capacity).

Refer to NCAP Tools Illustrative Example 3.5.4.

Identification of economic obsolescence does not require a formal decision to have been made by the agency to reduce the physical capacity of the asset. Agencies should also consider whether the surplus capacity is designed for stand-by or safety purposes, such as to deal with contingencies, in which case economic obsolescence may not exist despite the presently unused capacity.
Some examples indicators impacting on future service potential are outlined in the following table. Agencies will note that these indicators of change in service capacity/potential are similar to the indicators of impairment for assets within the public sector identified in *NCAP Tools Illustrative Examples 3.4.1 to 3.4.11.*

Indicator of Change in Service Potential / Capacity	**Potential Impact on Service Potential**
1. Cessation of the demand or need for services provided by the asset	The asset still maintains the same service potential embodied within, but demand for that service has ceased.
2. Significant long-term changes in the technological environment with an adverse effect on the asset	The service utility of an asset may be reduced if technology has advanced to produce alternatives that provide better or more efficient service.
3. Significant long-term changes in the legal or government policy environment	An asset's service potential may be reduced as a result of a change in a law or regulation.
4. Evidence is available of physical damage or deterioration of an asset	Physical damage/deterioration would likely result in the asset being unable to provide the level of service that it once was able to provide.
5. Changes in environmental conditions	An asset's service potential may be reduced as a result of environmental changes.

Indicator of Change in Service Potential / Capacity	Potential Impact on Service Potential
6. Significant long-term changes in the extent to which an asset is used, or is expected to be used.	If an asset is not being used to the same degree as it was when originally put into service or the expected useful life of the asset is shorter than originally estimated, the service capacity of the asset may be reduced. A significant long-term decline in the demand for an asset's services may translate itself into a significant long-term change in the extent to which the asset is used.
7. Significant long-term changes in the manner in which an asset is used, or is expected to be used.	If the asset is not being used in the same way as it was when originally put into service, the asset's service capacity may require reassessment or reduction.
8. Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected	Internal reports may indicate that an asset is not performing as expected or its performance is deteriorating over time.

3.6. REVALUATION METHODS AND FREQUENCY

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, agencies 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 assets that experience significant and volatile changes in fair value, annual revaluation will be required.

3.6.1. Methods of Revaluation

To ensure the carrying amounts of an agency's asset classes reflect their fair value at reporting date, subject to materiality, it is Queensland Treasury policy that each agency is to annually revalue the asset classes measured using the revaluation model as identified in NCAP 3.3 and Appendix 1.1 of NCAP 1 (subject to the exception for *for-profit* statutory bodies and agencies *not consolidated* into whole-of-Government financial statements).

It is Queensland Treasury policy that *specific appraisals* are required:

(a) to the extent that it has been more than five years since the individual asset has been subject to a specific appraisal;

OR

(b) in circumstances where indicators exist that the asset class has experienced a significant and volatile change in value since the last revaluation requiring all assets in that class to be revalued (and regardless of how recent that was and whether it was a specific appraisal or indexation); AND EITHER

(i) the significant and volatile change results wholly or partially from a change in the service potential / capacity of the asset (e.g. a reduction in service potential due to physical damage or economic obsolescence); OR

(ii) the application of an indexation method to the individual asset would not result in a materially correct estimation of fair value.

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 – see also section 3.8 below; and

- use of appropriate and relevant indices (*indexation*).

Indexation should be undertaken:

(a) to the extent the individual asset has been subject to specific appraisal within the previous five years; AND
   (i) the cumulative percentage change (refer below examples) in the relevant index has been more than 5% since the last revaluation (either by specific appraisal or indexation); AND
   (ii) indicators do not exist that the asset class has experienced a significant and volatile change in value since the last revaluation.

OR

(b) may be undertaken in lieu of a specific appraisal in circumstances where:

   (i) indicators exist that the asset class has experienced a significant and volatile change in value since the last revaluation (regardless of how recent that was, and regardless of whether it was a specific appraisal or indexation) requiring all assets in that class to be revalued; AND
   (ii) the significant and volatile change does not result wholly or partially from a change in the service potential / capacity of the asset; AND
   (iii) the application of the indexation method to an individual asset will result in a materially correct estimation of fair value.

The sole use of indexation would NOT be appropriate under this policy where the significant and volatile change in value results wholly or partially from a change in service capacity/potential of the asset (e.g. a reduction in service potential due to natural disaster or other damage). In such circumstances, a specific appraisal would be required.

3.6.2. Materiality

For asset classes that are required to be carried at fair value, the concept of materiality should be considered by agencies. On that basis:

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

- where the change in the total value of an asset class, since the last revaluation, can be demonstrated by the agency to be immaterial, that agency has discretion about whether or

not to account for that change (agencies are expected to monitor for factors that would indicate potentially material valuation changes for their assets); and

- agencies can exercise their discretion in determining whether only those material assets within a class (rather than all assets in that class) should be revalued. In such situations, agencies must ensure they have an appropriately robust policy for identifying those assets to be included in or excluded from the revaluation process.

When assessing whether an asset or asset class is material, controlled assets should be compared to the total controlled PP&E balance while administered assets should be compared to the total administered PP&E balance. If an agency 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.

3.6.3. Significant and Volatile Change in Fair Value

In terms of AASB 116, it is Queensland Treasury 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 20% or more.

(In the absence of a definition of 'significant' in the accounting standards, this policy position is based on the concept of 'significant influence' in accordance with AASB 128 *Investment in Associates* which provides that if an investor holds 20% or more of the voting power of the investee, it is presumed that the investor has 'significant influence', unless otherwise demonstrated not to be the case.)

Examples of indicators that the fair value of an asset class may have experienced a 'significant' change include (but are not limited to):

- increases in interest rates;
- rapidly deteriorating property markets;
- changes in prices of raw materials (if applicable) by more than 10%; or
- rapid wage growth in the construction industry (if applicable).

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.

Specific appraisal may be the only valid method of revaluation where a significant and volatile change in fair value occurs. However, as outlined above, Queensland Treasury policy permits the use of indexation for individual assets where the revaluation of the asset class is triggered by a significant and volatile change in value, on the condition that the use of indexation must result in a materially correct estimation of fair value. This will most typically occur where the significant change in value occurs in relation to an asset measured using current replacement cost because of significant and volatile increases solely in the cost of raw material and labour inputs.

In order to apply indexation to determine a materially correct estimation of fair value in such circumstances, it must be applied in a manner consistent with that used in the last specific appraisal. To meet this objective, indices may need to be revised at the lowest possible input level used in the CRC valuation model – *see NCAP Tools Illustrative Example 3.6.1*. In other cases, indexation may achieve a materially correct estimation of fair value where appropriate indices can be applied at the componentised level of an asset.

Agencies who apply indexation where significant and volatile changes in fair value occur must be able to provide supporting evidence to justify why the chosen index is appropriate and how it is applied to the assets within the asset class to achieve a materially correct fair value. The same principles, policies and restrictions apply as outlined under the "Use of indices" section below .

If the asset's fair value is unable to be reliably determined after the indexation method is applied, or it is inappropriate to use for a particular asset, then a specific appraisal must be undertaken.

3.6.4. Use of indices

It is Queensland Treasury policy that agencies must ensure that the application of indices would result in a valid estimation of the asset's fair value at reporting date. This requires that an agency ensure there is sufficient evidence that the index used is robust, valid and appropriate to the assets to which it is being applied.

To ensure consistency in fair value hierarchy categorisation between specific appraisals and indexation, it is Queensland Treasury policy that the application of indices not change the fair value level that applied as at the last specific appraisal (e.g. if a valuation at the last specific appraisal was categorised as level 2, subsequent indexation of that value would also be level 2).

Queensland government organisations available to provide advice on relevant and appropriate indices include (but are not limited to): the *State Valuation Service (SVS)* and the *Economic Statistics Section, Queensland Government Statistician's Office, Queensland Treasury*. The Queensland

Government Statistician's website is located at:
http://www.qgso.qld.gov.au/subjects/economy/prices/index.php

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

For the purposes of audited financial statements, CPI is not an appropriate index for the revaluation of non-current physical assets.

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.

For example:

- if the last specific appraisal was based on market selling prices for similar assets, subsequent indices should also reflect changes in market selling prices for similar assets. SVS can provide an 'individual factor change' per property, derived from the review of market transactions. Such market movements are determined having regard to the review of land values undertaken for each local government area as issued by the Valuer-General; and

- if the last specific appraisal used a current replacement cost technique, subsequent indices should also reflect changes in construction costs for similar assets. In this respect, specialised buildings may be indexed using a Building Price Index (BPI) based on recent tenders for typical specialised buildings. For residential buildings, the Cordell Housing Price index may be useful.

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. An agency 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.

Cumulative change refers to the movement in the relevant index compared to the base year, i.e. the year when the asset was last revalued. *NCAP Tools Illustrative Examples 3.6.2 and 3.6.3* illustrate how the cumulative change can be calculated using annual percentage changes in the relevant index.

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.

Where an agency does not believe this is appropriate, that agency should consult with Queensland Treasury (via FMC Support), stating their preferred categorisation and justification for that. Agencies will also need to negotiate this with their auditors.

3.7. TIMELINESS AND TIMING OF REVALUATIONS

Agencies are encouraged to obtain and recognise asset revaluations well prior to financial year end, to allow early external audit review and to reduce work in finalising financial statements after year end. Accordingly, it is acceptable for the date of recognition of revaluations to be earlier than year end.

As revaluations are likely to be recognised well before the end of the reporting period, agencies 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. Asset values recognised still need to materially reflect fair value as at year end (refer to paragraph 31 of AASB 116). For this reason, agencies are expected to take reasonable steps (possibly by subsequent liaison with valuers etc) to ensure fair values recognised earlier in the financial year remain reliable at year end.

Refer to NCAP Tools Illustrative Example 3.7.1.

3.7.1. Reassessment of service capacity at the end of the reporting period (for assets measured at CRC)

Where indicators exist at year end that the asset has experienced a material reduction in service capacity, a material change in remaining useful life, or other circumstances that that would influence the asset's valuation subsequent to the last CRC valuation completed, agencies must arrange for the fair values concerned to be reviewed and revised accordingly.

Refer to NCAP Tools Illustrative Example 3.7.2.

3.7.2. Relationship Between AASB 13 *Fair Value Measurement* and AASB 136 *Impairment of Assets*

Agencies are reminded that under AASB 136, the identification of impairment indicators and determining recoverable amount for property, plant, equipment and intangible assets measured at fair value is effectively incorporated into the fair value measurement (i.e. revaluation) process under AASB 13.

Not-for-profit agencies should refer to paragraph Aus5.1 of AASB 136 and sections 4.1 and 4.5 of NCAP 4 which specifically address the interaction between fair value measurement under AASB 13 and determining recoverable amount under AASB 136.

3.8. ENGAGEMENT AND APPOINTMENT OF VALUERS

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

It is Queensland Treasury policy that, for the purpose of issuing valuation instructions, agencies must ensure their correspondence with the valuer (or other relevant professional), at a minimum, includes the content in Appendix 3.3 Content Required from Valuers (or Other Relevant Professionals).

All non-current physical assets to be measured at fair value must be revalued by a suitably qualified person at least once every five 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 (refer to later in this section), quantity surveyors or engineers may have appropriate expertise.

An agency officer may be a suitably qualified person if they meet the following criteria:

- qualifications and experience - formal qualifications and/or significant practical experience in valuations; and
- ability to exercise professional judgement in:
- applying all relevant fair value measurement principles in AASB 13 *Fair Value Measurement*;
- identifying the highest and best use of the assets;
- selecting an appropriate valuation technique; and
- determining reasonable and supportable assumptions based on objective evidence and rational judgement.

Agencies should have regard to the NCAP Tool - Better Practice Guidelines for Valuation Instructions.

3.9. ACCOUNTING FOR REVALUATIONS – GROSS VS NET METHOD

It is Queensland Treasury policy that:

- **the net method of revaluation be used for specific appraisals using a market or income approach (e.g. discounted cash flows), where the assets so valued comprise a material proportion of the relevant class;**

- **the gross method of revaluation be used for specific appraisals using a cost approach (e.g. current replacement cost), where the assets so valued comprise a material proportion of the relevant class; and**

- **subsequent indexation should not cause a change in the method of revaluation used in the last specific appraisal.**

Paragraph 35 of AASB 116 and paragraph 80 of AASB 138 describe two methods allowed for dealing with accumulated depreciation/amortisation at the time of accounting for revaluations (i.e. the 'gross method' and the 'net method').

It is important that valuers (or other relevant professionals) are instructed as to the method of revaluation that applies under the circumstances. For example, for assets valued using a current replacement cost approach, for the purpose of restating accumulated depreciation under the gross method agencies should explicitly request both the gross replacement cost and new fair value (i.e. carrying amount).

Subsequent to initial application of the above policies, where an agency needs to change the broad valuation approach (e.g. from a market valuation to current replacement cost or vice versa) for an asset (which is expected to be rare), this will necessitate a change between the net and gross methods of revaluation. Such a change in revaluation method should be treated as a change in accounting estimate, as explained in paragraphs 65 - 66 of AASB 13. Therefore, such a change is to be applied prospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, but agencies should note the guidance in paragraph 66 of AASB 13 (regarding the disclosure requirements in AASB 108).

Depreciation subsequent to the revaluation continues to be accounted for in accordance with applicable requirements under AASB 116. NCAP 5.5 Other Depreciation Issues provides guidance on the recognition of subsequent depreciation.

3.10. SPECIFIC VALUATION ISSUES

3.10.1. Asset Revaluation Thresholds

Neither the Non-Current Asset Policies nor the *Financial and Performance Management Standard 2019* mandate a generic asset revaluation threshold.

3.10.2. 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.

Except for asset acquisitions subject to FRR 4F *Equity, Contributions by Owners and Distributions to Owners*, assets acquired by way of a gift, bequest, subsidised purchase, compulsory acquisition etc. must be valued initially at their fair value, consistent with the fair value principles in AASB 13 and guidance earlier in this chapter. Usual AASB 13 principles should be applied for dealing with transaction costs and transportation costs for such asset acquisitions (refer to paragraphs 25 – 26 of AASB 13, as well as the AASB 13 definitions for those terms).

A material difference between the transaction price and the fair value of an asset at that time should be accounted for as revenue (contribution revenue) or an expense (grant expense), according to the circumstances.

3.10.3. 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.

3.10.4. Heritage, Artworks and Cultural Assets

It is Queensland Treasury Policy that, 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.

***For-profit* statutory bodies and agencies *not consolidated* into the whole-of-Government financial statements have the discretion to choose the cost or revaluation model for heritage, artworks and cultural assets as explained in NCAP 3.3 Application of Fair Value Basis.**

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.

Some agencies control assets of significant heritage and cultural "value". These may be preserved solely for these attributes, or used in agency 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.

Agencies should also refer to AASB 116 paragraphs G1 to G4 for implementation guidance about heritage and cultural assets.

3.10.5. Intangible Assets

The revaluation model must be applied if the fair value of an intangible asset can be determined by reference to an active market. Due to the limited circumstances when fair value can be used under AASB 138 *Intangible Assets*, only a market approach or income approach can be used for intangible assets.

If an intangible asset (that has never been revalued) in a class of revalued intangible assets cannot be revalued because there is no active market for the asset, the asset is to be carried at its original cost to the entity less any accumulated amortisation and impairment losses.

If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the asset is carried at cost (with its revalued amount at the date of the last revaluation by reference to the active market being its "deemed cost") less any subsequent accumulated amortisation and impairment losses. In such a situation, it is expected that an explanation be disclosed in the notes.

The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with AASB 136 *Impairment of Assets.*

If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

3.10.6. Investment Property

Investment property is to be initially recognised at cost, including transaction costs as per AASB 140 *Investment Property*.

After initial recognition, a not-for-profit agency consolidated into the whole-of-Government financial statements must measure all of its investment property, including investment property under construction, at fair value except where fair value cannot be measured reliably. However, *for-profit* statutory bodies and agencies *not consolidated* into the whole-of-Government financial statements are permitted to choose either the cost or revaluation model for investment property – refer to NCAP 3.3 Application of Fair Value Basis.

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.

There may be exceptional circumstances when an agency first acquires an investment property (or when an existing property first becomes an investment property following the completion of construction or development or after a change in use) when the fair value of the investment property is not reliably measurable on a continuing basis. This only occurs when comparable market transactions are infrequent, and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available.

In such cases, the cost model under AASB 116 is to be applied to that property until the disposal of the investment property or a reliable fair value can be determined, whichever is the earliest. The requirements that apply where fair value cannot be determined reliably are contained in

paragraphs 53 – 55 of AASB 140. In all other circumstances, investment properties for which reliable fair values can be obtained must be measured at fair value.

3.10.7. Valuation of Asset Groups or Complex Assets

If an agency undertakes a valuation for a complex asset (refer to NCAP 2 Complex Assets) or an entire asset group, it may be difficult to identify a fair value for each individual asset/significant component. Where the value of individual assets/significant components cannot be reliably determined, the total value is to be allocated across the individual assets/components on a consistent and rational basis as determined and documented by the agency. The ratio of the original cost of an asset/significant component to the original cost of the whole may be an appropriate basis for such an apportionment.

3.10.8. Leased Assets

Agencies should refer to FRR 4B.9 for Treasury's lease accounting policies.

3.10.9. Service Concession Assets

The measurement methods prescribed in Appendix 1.1 of NCAP 1 for classes of PP&E and intangibles also apply to classes of service concession assets.

In accordance with AASB 1059 paragraph 9(b), service concession assets that are measured under the revaluation model must be valued at current replacement cost, i.e. using the cost approach.

3.10.10. Assets Withdrawn Permanently from Use

An idle asset or a permanently retired asset exists where:

- a physical or intangible asset has not been employed and/or has been unoccupied for 12 months or more;
- the carrying amount of the idle/permanently retired physical or intangible asset(s) is/are material to the relevant asset class; and
- no plans exist to reinstate the asset to use.

In contrast, a temporarily idle physical or intangible asset is intended to be re-employed by the agency in future reporting periods.

Where an asset is to be withdrawn permanently from use, for example, because it has been replaced or because it is surplus to requirements, an agency must review the carrying value of that asset. Where the asset is to be withdrawn permanently from use, it is to be valued at selling price or scrap value.
Where an asset is revalued at fair value, AASB 116 requires that asset's entire class to be revalued (effectively preventing selective revaluation of assets). However, two situations need to be considered in relation to the permanent withdrawal of an asset:

1. Sale - where the asset is to be sold, the provisions of AASB 5 *Non-Current Assets Held for Sale and Discontinued Operations* may apply.

2. Abandonment - an *abandoned* asset is one which has been decommissioned or scrapped. Assets of this type are normally at the end of their useful life or are used until they are closed down. The write-off of the old asset is treated according to the provisions of AASB 116.

3.10.11. Renewals Accounting

It is Queensland Treasury policy that the 'renewals accounting' approach, where all expenditure on an asset is recognised as an expense in the period in which it is incurred, without consideration of whether increases in future economic benefits have resulted, is <u>not permitted</u>.

3.10.12. Library Collections

If valuations of library collections are conducted in-house, it is Queensland Treasury policy that the methodology and assumptions underpinning the valuation are to be independently reviewed (e.g. by an expert valuer or by the in-house expert of another entity with a similar library collection) at least once every five years to ensure the appropriateness of the valuation approach.

For library collections, it is preferred that revaluations be undertaken by independent, professionally qualified experts. This helps ensure fair, 'arm's length' valuations of the collections. However, particularly for heritage collections, there may be few independent valuers with the expertise to value certain collections. In these instances, employees with relevant expertise/knowledge may undertake an in-house review.

<u>Reference collections</u>
Where market prices can be obtained for a library reference collection, a market approach should be used.

Where market prices are not available, a cost approach may be used. An average replacement cost may be used, based on the average cost of purchases over a period considered to most closely provide an accurate average value for the reference collection. Using this method, the average cost is to be applied to all capitalised materials in the collection at year-end.

Generally, a maximum rolling five-year period is considered appropriate for determining average replacement cost on the basis that five years should provide a smoothing of any peaks and troughs experienced in the cost of books. For example, there may be one year when a large number of high value law textbooks are purchased. If this average cost was applied to all items in the collection, over-inflation of the fair value may result. Using a five-year rolling average cost should result in this peak being effectively managed. However, a longer or shorter period may be used at management discretion where this is justified.

The basis for determining the appropriate 'averaging' period is to be documented. Once determined, this period should be consistently applied.

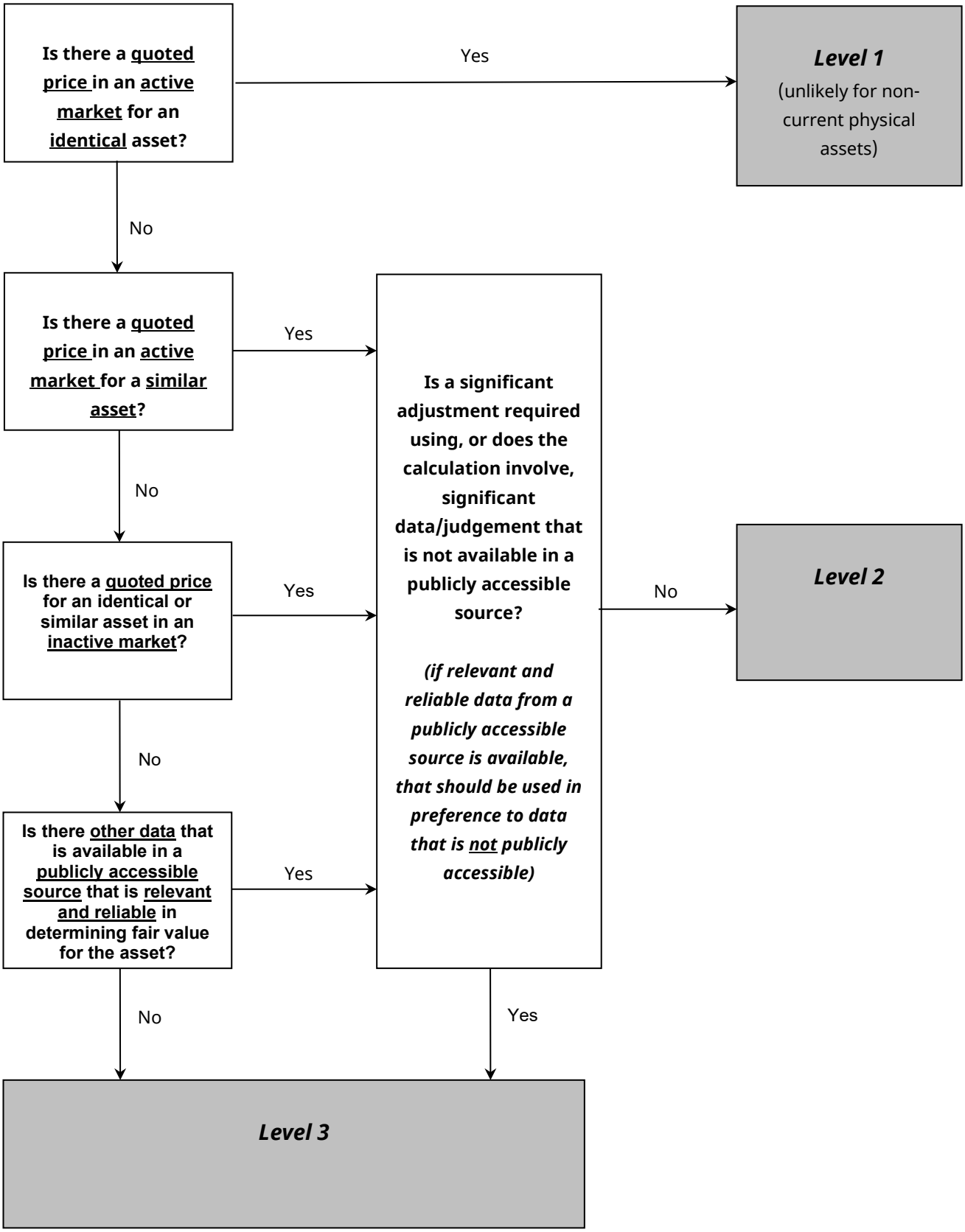
The formula to calculate replacement cost of the library reference collection would be as follows:

	opening number of items held at start of the financial year
+	number of purchases and other acquisitions during financial year (including transfers in)
–	number of disposals and write-offs during financial year (including transfers out)
=	closing number of items held at year end
x	average cost over the relevant period applied (i.e. total value of purchases/number of items purchased)
=	total replacement cost for the reference collection at year end

Note: Per NCAP 1, where multiple copies of an item are held, only one copy (per location) is to be included in the calculation.

In calculating average cost, agencies should determine any identifiable sub-collections and calculate the average cost of all items purchased over the previous five years according to these sub-collections e.g. medical textbooks or periodicals. This average cost should then be applied to all capitalised items within that sub-collection including material acquired for no cost, ensuring these are assigned a replacement value. If the agency determines that differentiating by sub-collections is not providing an accurate fair value, then the agency should consider stratifying the sub-collections e.g. into value bands, to calculate fair value.

APPENDIX 3.1 – DETERMINATION OF FAIR VALUE HIERARCHY LEVEL



APPENDIX 3.2 – FAIR VALUE MEASUREMENT EXPECTATIONS

Asset class/category	Examples of types of assets	Expected fair value level *	Likely valuation approach	Net vs gross revaluation method ^
Land	In areas where there is an active market – vacant land land not subject to restrictions as to use or sale	Level 2	Market or income approach	N/A – as land is not depreciated
Land	Land subject to restrictions as to use and/or sale Land in areas where there is not an active market	Level 3	Market or income approach	N/A - as land is not depreciated
Buildings	General office/ commercial buildings	Level 2 or 3, according to significance of adjustments using unobservable data/ judgements	Market or income approach	Net method
Buildings	Specialised buildings with limited alternative uses and/or substantial customisation e.g. prisons, hospitals	Level 3	Cost approach	Gross method
Infrastructure	Any type except as below	Level 3	Cost approach	Gross method
Infrastructure	Assets where the highest and best use would be to generate net cash inflows	Level 3	Income approach	Net method

Asset class/category	Examples of types of assets	Expected fair value level *	Likely valuation approach	Net vs gross revaluation method ^
Major Plant and Equipment	Non-specialised	Level 2 or 3, according to significance of adjustments using unobservable data/ judgements	Market or income approach	Net method
Major Plant and Equipment	Specialised items with limited alternative uses and/or substantial customisation	Level 3	Cost approach	Gross method
Heritage and Cultural Assets	Items for which there is no active market and/or for which there are limited uses	Level 3	Cost approach	Gross method
Heritage and Cultural Assets	Items for which there is an active market and there are operational uses for the item	Level 3 (due to significant judgement expected to be required)	Market approach	Net method
Intangibles	Where there is an active market for that intangible (otherwise, intangibles must not be revalued)	Level 2	Market approach	Net method

* Queensland Treasury must be consulted (via fmcsupport@treasury.qld.gov.au) if an agency believes the expected fair value level is inappropriate in individual cases by stating its preferred fair value categorisation and justification for that. That agency will also need to negotiate this with its auditors.

^*Refer to NCAP 3.9 'Accounting for revaluations – gross vs net method'.*

APPENDIX 3.3 – CONTENT REQUIRED FOR VALUERS (OR OTHER RELEVANT PROFESSIONALS)

This Appendix outlines the minimum information required from parties who have been engaged to provide a fair value for financial reporting purposes. This Appendix should be read in conjunction with the information provided in NCAP 3 (including NCAP Tools - Better Practice Guidelines for Valuation Instructions)

VALUATION INSTRUCTIONS - Correspondence to external parties setting out instructions for the determination of fair value, at a minimum, must include the following requirements:

- conformity with the fair value principles and guidance in Queensland Treasury's *Non-Current Asset Policies* and AASB 13, including the principles about the market and/or the most advantageous market, market participant assumptions, and highest and best use is the asset's current use (unless the asset is classified as held for sale under AASB 5 or it becomes highly probable that the asset will be used for an alternative purpose, in which case the instructions should be suitably varied);

- the valuation approach expected to be used, and the method of revaluation to be used (i.e. net method or gross method – refer to NCAP 3.9 Accounting for Revaluations - Gross vs Net Method and Appendix 3.2 Fair Value Measurement Expectations). For example, where the gross method of revaluation is used, both the gross replacement cost and new fair value (i.e. carrying amount) should be requested;

- conformity with Australian Accounting Standard AASB 136 *Impairment of Assets* ***(if applicable);***

- in the case of complex assets, provision of fair values for individual components or parts;

- usage of defensible and consistent methodologies to determine valuation assumptions and techniques when there is insufficient relevant observable data to determine a fair value (e.g. a cost approach may be used in the latter circumstances and/or if sale/transfer will never be possible/permissible);

- maximum usage of relevant observable data inputs, and minimum usage of unobservable data inputs, as far as possible;

- calibration of the valuation technique, where appropriate, to ensure the technique results in a reliable fair value. Where there are significant valuation uncertainties, the valuer should use more than one valuation technique and compare the results before a final valuation is determined;

- in respect of all assets valued, provision of information for the relevant disclosure requirements to comply with AASB 13; and

- a statement that all data supplied to the valuer and the report and data provided by the valuer to the agency is the property of the Queensland Government should be included, and that the agency should have full access to any supporting documentation for verification of reports, if required.

INFORMATION REQUIRED FROM VALUERS (OR OTHER RELEVANT PROFESSIONALS) - At a minimum, the following information must be obtained, applicable to each asset valued:

- the effective date of the valuation;

- a statement that the valuers have complied with the relevant accounting standards (e.g. AASB 13) and Queensland Treasury's *Non-Current Asset Policies*. In respect of land valuations, the valuer must be registered under the Queensland *Valuers Registration Act 1992*;

- whether or not the asset was physically inspected;

- significant assumptions used (e.g. whether the principal or most advantageous market was used, restrictions that exist, who the market participants would be, and what they would take into account);

- highest and best use has been determined based on current use, and if not, the alternate basis;

- the proposed fair value hierarchy level of valuation;

- the valuation technique (including whether more than one valuation technique was used, and justification for the technique chosen in terms of the AASB 13 principles) and details of the calculations;

- data inputs used and their sources (e.g. whether they are observable or not, and whether or not transportation costs have been included and why), and methods used to develop and substantiate unobservable data;

- where significant unobservable data inputs (or significant unobservable adjustments made to observable data) are used – the rationale for doing so, nature and possible variation in

such data inputs, and changes in fair values if an alternative amount is applied to the unobservable inputs;

- reason(s) for any changes in valuation technique/methodology or inputs used;

- for valuations undertaken using a cost approach - the gross replacement cost and new fair value (i.e. carrying amount);

- other relevant information regarding how the valuation was conducted and how the fair values were derived, including provision of support for the reasonableness of the valuations, whether there is an increase, decrease or no change. This should include relevant information about past and predicted future trends in fair values for the type of assets valued, and comparisons to other fair values obtained during the reporting period.