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VALUATION OF ASSETS AT FAIR VALUE

As outlined in Circular 06-43 – Financial Reporting 2006, the valuation of non-current assets at 'fair value' will be introduced in a staged approach as follows:

2006/07 - Water and sewerage
2007/08 - Property, plant and equipment, land, buildings and other
2008/09 - Roads, bridges, footpaths and drainage

Councils are required to report on water and sewerage assets at fair value in their 2006/07 financial reports. This circular provides information relevant to the revaluation of these assets. It does not provide advice on how to account for the revaluation changes. Councils should refer to the Local Government Accounting Code of Practice and Financial Reporting (the Code) and AASB 116 (Property, Plant and Equipment) for this information.

The revaluation of assets to fair value in 2006/07 applies to the entire class of water and sewerage assets. All water and sewerage assets will be carried in the books at their revalued amount, being their fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment costs.

'Fair Value' is the best estimate of the price reasonably obtainable in the market at the date of the valuation. As defined in AASB 116 it is "*the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction".*

Generally fair value is the most advantageous price reasonably obtainable by the seller and the most advantageous price reasonably obtained 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.

Valuation of specialised plant and infrastructure

Where there is no market-based evidence of fair value, council may need to estimate fair value using the depreciated replacement cost approach. Depreciated replacement cost "*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*". In the case of water and sewerage assets, replacement cost is assessed using the Modern Engineering Equivalent Replacement Asset (MEERA) approach, i.e. where the replacement cost of an asset is assessed on the basis of design and construction using modern technology.

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In using the depreciated replacement cost approach, careful consideration needs to be given to depreciation and the asset's useful life. AASB 116 and the Code provide detailed commentary on this.

All new assets are measured initially at their cost of acquisition. Where an asset is acquired at no cost, the cost of the acquisition is deemed to be the asset's fair value. The 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 will impact on fair value where depreciated replacement cost is used.

Future Revaluations

Councils need to assess 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 council determines the asset's fair value and revalues the asset to that amount. It is recommended that revaluation occur every 3 to 5 years, so councils should develop a plan for assessing the need for any revaluations, allowing sufficient time to undertake the revaluation process and meet reporting requirements.

Councils are also reminded that water supply and sewerage asset values are to be annually indexed between revaluations in accordance with page 1 of the *NSW Reference Rates Manual for Valuation of Water Supply, Sewerage and Stormwater Assets, 2003*. National indexing valuations are being developed currently and once completed, indexing for other asset categories will be aligned.

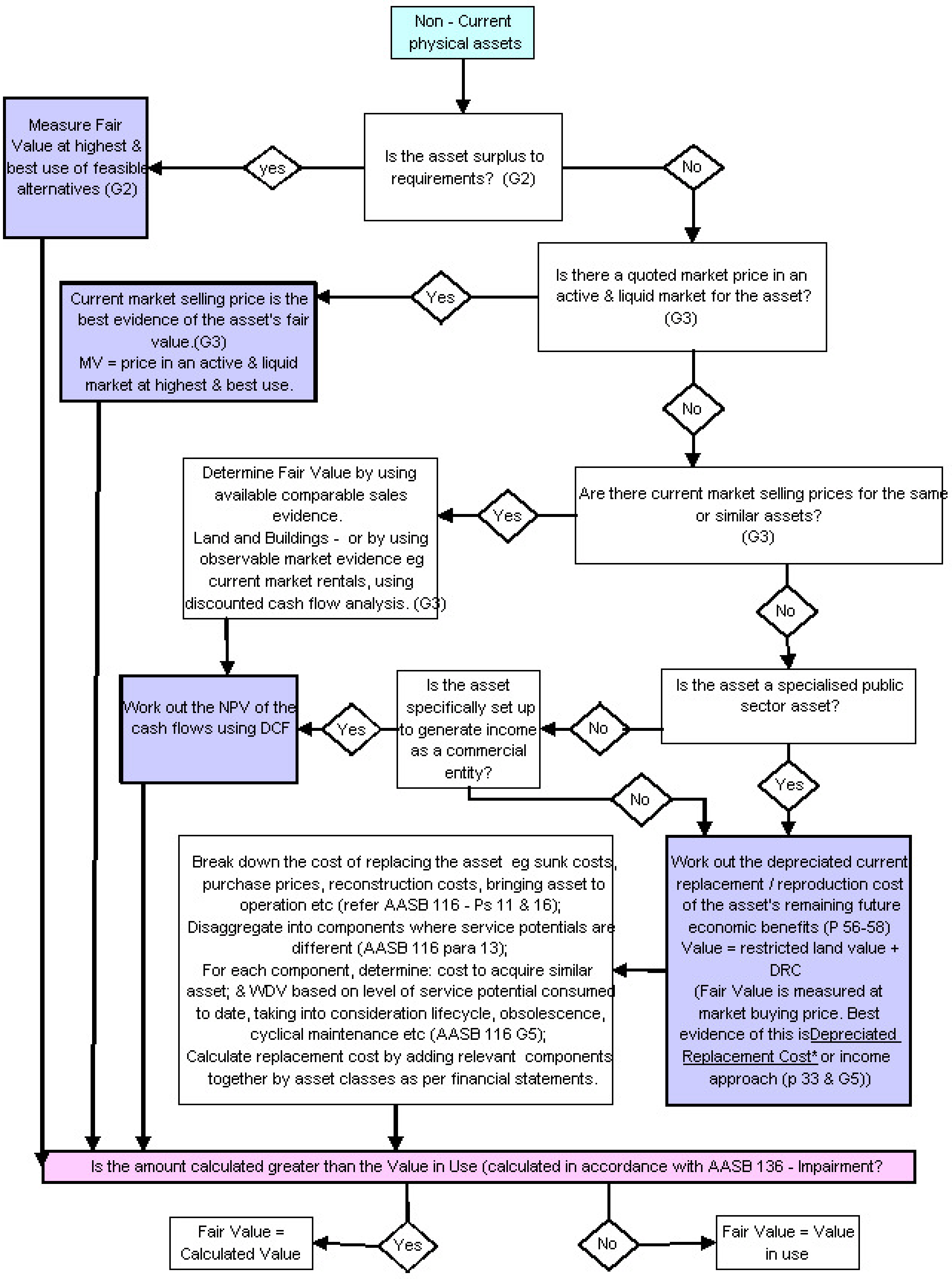
Reporting Requirements

There are a number of financial reporting disclosures that apply in respect to revaluations and these are detailed in AASB 116. Councils should familiarise themselves with these paragraphs in order to meet the financial reporting requirements for the revaluation of water and sewerage assets in 2006/07.

Councils who wish to revalue assets at fair value in other asset categories prior to the dates stated above may do so provided that all assets in the class of property to which any revalued item belongs are also revalued at fair value. The carrying amount of such assets will be their fair value at the date of revaluation less any subsequent accumulated depreciation and impairment (refer AASB 116, 31-42).

Appendix A is a fair value decision tree to assist councils when revaluing assets. For a more detailed explanation on valuing non-current physical assets, councils should refer to AASB 116.

Garry Payne
Director General



Revaluation: assess at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determind if the asset were revalued at the reporting date. (AASB 116, para 31, G6 & G7). See also paras 34 and 36.

*Depreciated Replacement Cost(Water supply and sewerage assets) - replacement cost assessed uisng MEERA (Modern Engineering Equivalent Replacement Asset) approach.