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VALUATION OF PROPERTY, PLANT & EQUIPMENT AT FAIR VALUE

In July 2006 the Department mandated that NSW councils commence valuing the property, plant and equipment assets of councils at fair value in accordance with Australian Accounting Standard AASB 116, "Property, Plant and Equipment".

As outlined in Circular 06-43 – Financial Reporting 2006, the valuation of non-current assets at 'fair value' is being introduced in a staged approach. Councils were required to revalue the water and sewerage assets by 30 June 2007. During the year ending 30 June 2008, councils were to revalue land, buildings, plant and equipment and other assets.

In preparing and planning for this process, several questions have arisen in relation to the fair value of these asset classes. This circular proposes to address these issues for councils.

In summary the Department of Local Government, together with the Local Government Accounting Advisory Group, has determined that:

- All councils' operational land is to be valued at fair value by 30 June 2008.
- The fair value of community land has been deferred until 2010.
- Buildings are to be classified as specialised or non-specialised buildings and divided into depreciable components. The suggested minimum components are as follows:
    * the roof
    * fire services such as sprinkler systems
    * transportation services such as lifts and escalators
    * mechanical services such as air conditioning, hot water systems
    * floor coverings such as carpets, tiles, etc
    * the 'structural shell' of the building.
- Fair value of plant and equipment is deemed to be the depreciated replacement cost where it is evident that there is no impairment.
- Fair value of other assets has been deferred until 2009. Further information of what constitutes other assets is detailed further in the circular.

1. Land

Councils in New South Wales own or control various types of land assets. Council land must be classified as either operational or community. Operational and community land is defined in the *Local Government Act, 1993*.

To ensure compliance with AASB 116 "Property, Plant & Equipment" land is to be valued having regard to the highest and best use after deducting costs to sell. Highest and best use is the use of the asset that is physically possible, legally permissible, financially feasible that results in the highest value.

a) Operational Land

Operational land should be valued at market value (highest and best use) after identifying all elements that would be taken into account by buyers and sellers in setting the price including but not limited to:

- the land's description, area and / or dimensions,
- planning and other constraints on development, and
- the potential for alternative use

Typically operational land should be valued using an independent qualified valuer. Each council should ensure they organise valuations as soon as possible and that independent valuers are provided with detailed written valuation instructions.

Councils should also consider engaging valuers on a regional basis and should discuss this option within Strategic Alliances and/or Regional Organisations of Councils.

b) Community Land

In most cases an active market will not exist for community land. As a result, highest and best use may not be determined using comparison to market values for similar assets. AASB 116 paragraph 33 provides:

"If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach."

There has been some debate in relation to the correct accounting treatment of assets that councils are said to have control, such as, crown land and rural fire service assets. Also, NSW Treasury Policy states that there may be socio-political restrictions that may result in there being no feasible alternative use for some land and therefore impede the value of the land.

It is considered that valuing community land at fair value is more complex than operational land. In light of this and to ease the burden on councils, the Department of Local Government has deferred the requirement for councils to re-value community land from 30 June 2008 until 30 June 2010.

As there is uncertainty in relation to the abovementioned it is recommended that councils defer the revaluation of community land until these matters are resolved and the Department issues further information.

c) NSW Valuer General Land Valuations

In most cases councils will not have valuations for parks, reserves or other specialised land, or valuations that reflect "replacement cost" for each specialised land asset.

Valuations issued by the NSW Valuer General for rating purposes do not represent fair value in accordance with the requirements of AASB 116. This is because rating valuations do not consider all property use matters and restrictions that are required when assessing its market value.

As a result, councils in NSW cannot rely on Valuer General land valuations for rating purposes to satisfy the requirements of AASB 116.

d) Use of an Independent Qualified Valuer

The use of a qualified independent valuer will ensure compliance with Australian Accounting Standards where:

i) the valuer is provided with valuation instructions that are concise and adopt the requirements of AASB 116 and

ii) the valuer can demonstrate sufficient knowledge and experience that will provide council (and its auditor) with confidence that the relevant valuations will be prepared in accordance with AASB 116.

e) Value-Adding / Cost Reduction When Obtaining Land Valuations

As councils will be required to obtain independent land valuations using methodology that complies with AASB 116 councils should consider obtaining building valuations for fair value and insurance value at the same time. Any land improvements that should be accounted for could also be performed by the same valuer, which may reduce the costs of compliance for each council.

2. Buildings

In relation to buildings, questions have been raised regarding the level to which the building should be divided into components when revaluing.

When revaluing council owned and controlled buildings, councils should utilise the classifications of “non-specialised buildings” and “specialised buildings”.

Non-specialised buildings are general purpose or commercial buildings where there is a secondary market and a market value can be determined by appraisal.

Specialised buildings are those buildings that are designed for a particular purpose. Where there is no market-based evidence available specialised buildings should be valued at depreciated replacement cost.

a) Building components
Buildings (non-specialised and specialised) consist of separately identifiable components that have different useful lives. Whilst each council will own or control various buildings with different purposes, when valuing each building a council should identify the material components that have different useful lives and record and depreciate them accordingly.

The Department of Local Government has adopted a recommendation of the Local Government Accounting Advisory Group that when councils are breaking-down buildings into depreciable components, the emphasis should be on materiality and the suggested minimum components for buildings is as follows:

- the roof,
- fire services such as sprinkler systems
- transportation services such as lifts and escalators
- mechanical services such as air conditioning, hot water systems
- floor coverings such as carpets, tiles etc
- the 'structural shell' of the building

When identifying building components consideration will need to be given to such buildings as aged care facilities where regular renovation work is required to maintain accreditation with the relevant government departments.

b) Use of Independent Valuer versus In-House Expertise to Value Buildings
It should be noted that buildings and other structures do not have to be valued using an independent valuer where a council has sufficient in-house expertise to perform such a task. However, before utilising in-house resources to value buildings each council should discuss their approach with their external auditor to confirm the information requirements that are necessary to enable the auditor to form an opinion on each asset valuation prepared. The cost of auditing each valuation prepared in- house when compared to the cost of acquiring external professional valuation resources should be considered.

3. Plant & Equipment
For NSW councils this asset type will comprise of construction equipment, road making plant and equipment, motor vehicles, office equipment etc.

Physical non-current assets are to be valued at fair value in accordance with Australian Accounting Standards AASB 116 "Property, Plant and Equipment" and AASB 140 "Investment Property". Fair value is defined as "*the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction"* (AASB 116, para 6, AASB 140, para 5).

In light of the nature and value of council plant and equipment, the Department has determined that NSW councils may use depreciated replacement cost as fair value as long as council has undertaken a high level review to determine if there has been any impairment to the assets. Depreciated replacement cost will also be appropriate where each council documents that it has assessed useful lives at each balance date and has utilised residual values for each item of plant and equipment.

4. Other Assets

Other assets are any assets that are not land, land improvements, buildings, roads, drainage, water, sewer, plant and equipment or furniture and fittings. Some specific assets included in this class are works of art, library books (common use, reference and heritage collections), items or artefacts of cultural or heritage significance, playgrounds, other parks and garden assets etc.

Circular 06-43 stated that other assets were to be valued by councils during the year ending 30 June 2008. Due to the specialised nature, the intricacy involved and the time needed to revaluing assets of heritage and cultural significance the Department has decided to allow councils until 30 June 2009 to determine the fair value of other assets.

Further information and guidance will be provided on the fair value of this asset class at a later date.

Councils are reminded that while the valuation of community land has been deferred till 30 June 2010 and the valuation of other assets has been deferred till 30 June 2009 councils will need to revalue roads and drainage (stormwater assets[1]) by 30 June 2009.

5. Resources available for councils

Australian Accounting Standards Board
http://www.aasb.com.au/

NSW Treasury
Accounting of Physical Non- Current Assets at Fair Value
http://www.treasury.nsw.gov.au/

[1] Guidance and reference rates for the valuation of stormwater assets are available in the Department of Water and Energy's *Reference Rates Manual for Valuation of Water Supply Sewerage and Stormwater Assets, updated August 2007* (www.deus.nsw.gov.au/publications).

NSW Audit Office
Awareness publications
http://www.audit.nsw.gov.au/

While this circular gives councils information in relation to the re-valuation of Local Government property, plant and equipment it is by no means intended to cover all aspects of fair valuation and councils should refer to the Australian Accounting Standards for detailed explanation and their auditors.

Garry Payne AM
Director General