Covid-19 and Natural Disasters: A Practical Guide to Timing of Valuations of Property, Plant and Equipment

1. Introduction

Recent natural disasters and the economic uncertainties created by the current Covid-19 pandemic, mean agencies need to be careful when assessing the fair values of property, plant and equipment (PPE) at 30 June 2020. There is an increased risk that unexpected events or significant changes in assumptions used in fair value measurements, mean that management will need to change their planned valuation approach.

This guide is intended to highlight some of the practical timing challenges that may arise in the current uncertain environment and potential approaches that agencies should take to address these. **Agencies should refer to other publications for guidance on the technical aspects of PPE valuations due to Covid-19**.

The main sources of reference remain the Accounting Standards, including AASB 13 *Fair Value Measurement* (AAASB 13) and AASB 116 *Property, Plant and Equipment* (AASB 116), as well as Treasury policy TPP 14-01 *Valuation of Physical Non-Current Assets at Fair Value*. Agencies should continue to refer to these publications.

2. TPP 14-01 and frequency of valuations

TPP 14-01 only requires comprehensive valuations every 3 or 5 years depending on the type of PPE. However, in those years a comprehensive valuation is not planned, agencies are required to assess whether there is any indication that an asset's carrying amount differs materially from fair value at the reporting date (a ***management assessment***). Where an indication does exist, that asset must be revalued to fair value.

Generally,

- an interim management revaluation should be undertaken when cumulative increases / decreases in indicators / indices are generally less than or equal to 20%. Interim management revaluations involve using management (or internal) expertise by applying the relevant indexation factors (refer section 8.2) to the carrying amount
- an interim formal revaluation should be undertaken where there has been a cumulative increase / decrease in indicators / indices generally greater than 20%. Interim formal revaluations involve using external professionally qualified valuers (either to conduct the revaluation or to review the revaluation).

Note: these thresholds are indicative only. Agencies must apply professional judgement to determine whether an interim revaluation is necessary, and which type of interim revaluation is most appropriate.

TPP 14-01 section 8.1.3 page 33

Monitoring valuation processes during Covid-19
This means in certain circumstances, agencies must take action regarding remeasuring the relevant PPE, even if a comprehensive valuation was not planned for that financial year. That action could be a management valuation, a formal external valuation that is not comprehensive, or a full comprehensive external valuation.

Due to the current uncertainties, agencies should continuously monitor for information relevant to valuations and update their management assessments, or valuations accordingly. In certain circumstances, agencies may need to change their planned valuation approach. For instance, it may become necessary to change from a management assessment to a management or formal valuation; or from a management valuation to a comprehensive valuation.

Table of Valuation approaches and Key Milestones

3. General considerations, including where PPE <u>IS subject to a planned comprehensive valuation</u> in 2019-20

This section covers considerations for valuations of PPE being performed for the 2019-20 financial year. Generally, this will be PPE being revalued as part of the 3 or 5 year cycle required by TPP 14-01 ('in-cycle' PPE). However, the guidance is also relevant for PPE where valuations were not required by the 3 or 5 year cycle ('out-of-cycle' PPE). In particular, agencies need to be alert to factors that may mean valuations are in fact necessary for PPE that is out-of-cycle. Specific out-of-cycle considerations are discussed below.

Evidence in Valuers Reports
In the current environment, valuers may use different data sources or assumptions in their valuations. For example, there may be less market data available from usual sources, or discount rates or risk premiums may have changed significantly. There may also be greater uncertainty over the reliability of valuation inputs.

It is therefore, particularly important that agencies understand the assumptions and inputs valuers will use and that these are adequately documented in the valuation report. Agencies should ensure that the assumptions and inputs are specific and appropriate to the asset being valued. Treasury expects auditors will focus closely on evidence supporting valuations for 2019-20. Valuation reports should also identify and justify any adjustments to observable inputs. For example, where the valuer applies an adjustment to recent land sales, for restrictions.

Regular Updates to Valuations
Most agencies obtain valuations as at 31 March, as part of Early Close. Due to the potential for changes, agencies should ensure they consider whether valuations need to be updated at each of these points:

(i) 30 June 2020
(ii) Immediately before signing of agency financial report
(iii) Immediately before signing of TSSA – if substantially different to (ii)

It is recommended agencies maintain regular contact with their valuers, to identify the likelihood valuations need to be updated.

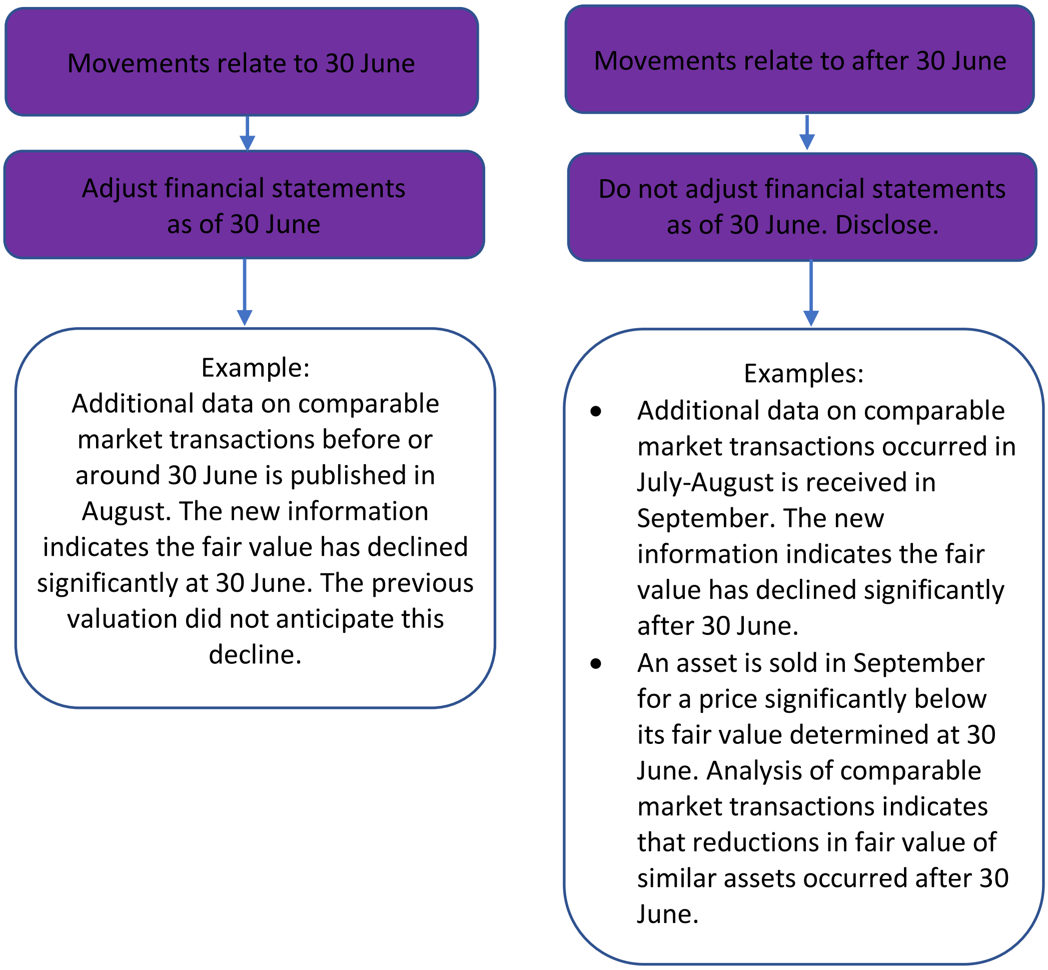
Post-Balance Date Events
A range of data is used in performing valuations, including published market data, discount rates and projections of future cash flows. In the current environment, some data may be subject to increased uncertainty and/or volatility.

It is particularly critical this year that agencies understand the data used, including the period to which it relates. Significant new information that arises after 30 June 2020 should be assessed to determine whether it relates to fair values at 30 June 2020. Agencies should also refer to AASB 110 *Events after the Reporting Period* (AASB 110) and Treasury *Guidance on likely Financial Reporting impacts of COVID-19 Events after balance date.*

For example, if published information on market prices becomes available after 30 June, that relates to market transactions that occurred during June, management will need to consider if the fair value determined as at 30 June is materially correct. However, this does not necessarily mean the 30 June valuation is not materially accurate, because the valuation may have taken into account earlier published information as well as unpublished information about June transactions.

Material Events After Balance Date

Evidence of significant fair value movements that becomes available between 30 June and the date of signing of financial reports, needs to be assessed to determine whether **the movements relate to 30 June or the period after 30 June**.



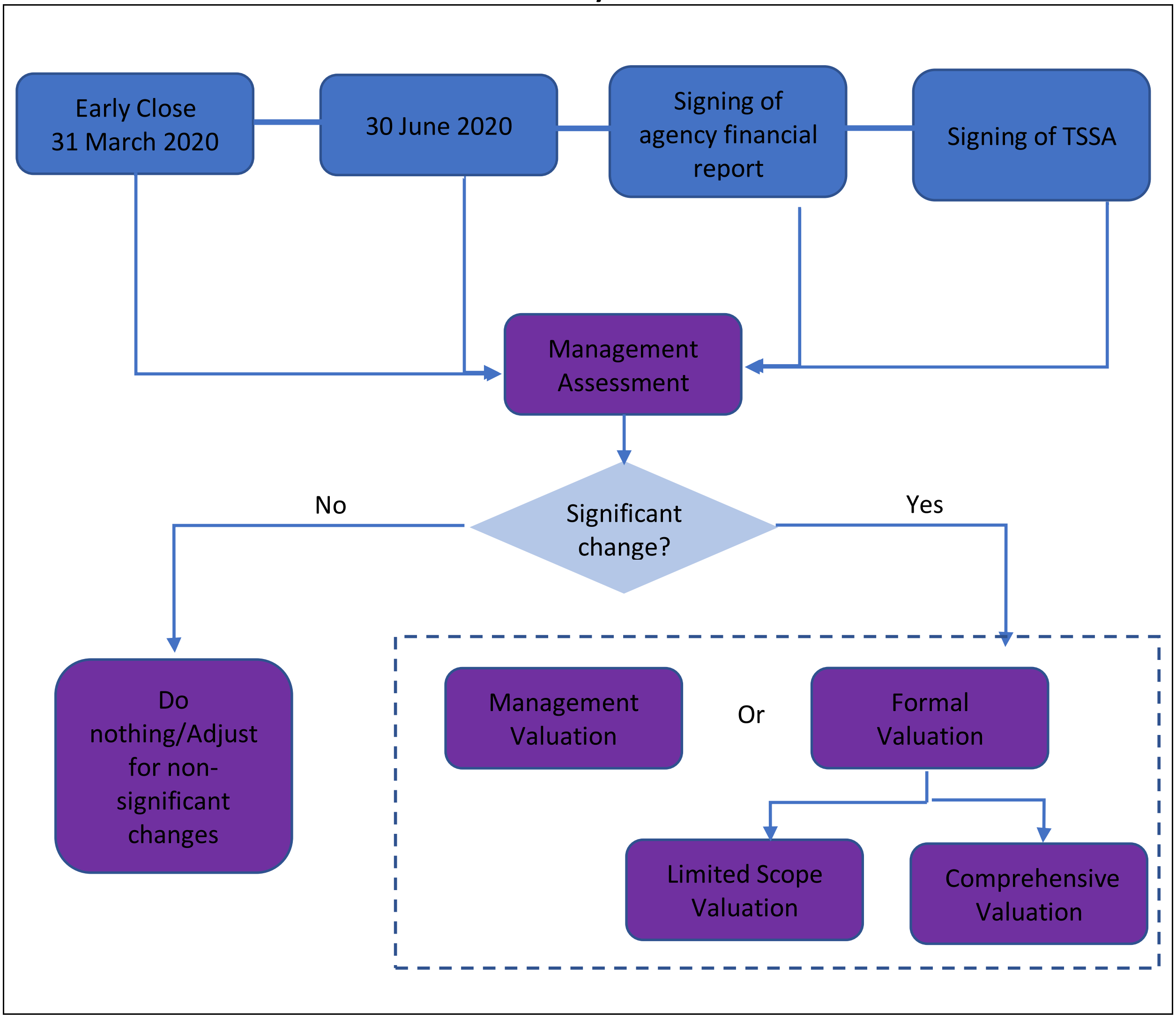
4. Specific considerations where PPE is <u>NOT subject to a planned comprehensive valuation</u> in 2019-20

To address the risk of uncertainty of new information becoming available about fair values at 30 June 2020, it is important agencies perform and update their management assessments of fair values on a regular basis. At a minimum at these key points in the year-end cycle:

- Early Close 31 March 2020
- 30 June 2020
- Immediately prior to signing agency financial report
- Immediately prior to signing of the TSSA

If at any point in the cycle, the management assessments of fair value indicate a potential material difference between far value and carrying value at 30 June 2020, agencies will need to change their planned approach and perform a valuation. The type of valuation will depend on the circumstances and potential materiality.

Decision tree: out-of-cycle PPE - 2019-20



5. Notify Treasury of Major Concerns

Agencies should engage with their audit teams and contact Treasury if they have significant concerns regarding the timing or format of their PPE valuations for 2019-20. These could include:

- Content of valuation reports, including potential lack of detailed evidence to support assumptions.
- Decisions to perform formal revaluations out-of-cycle.
- Valuer disclaimers.