NSW Treasury

TPG23-09 Guidance when performing valuations of physical non-current assets

TPG23-09

March 2023

Acknowledgment of Country

We acknowledge that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

We pay respect to Elders past and present and commit to respecting the lands we walk on, and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork:
Regeneration by Josie Rose

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Key information	
Treasury Policy and Guidelines (TPG) is relevant to?	☒ GSF Agencies ☐ General Government Sector ☐ Public non-financial corporation ☐ Public financial corporation ☐ State Owned Corporations ☐ Other
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Document contains
☐ **MANDATORY POLICY** compliance set out by NSW Treasury.
☐ **RECOMMENDED POLICY** reflecting best practice standards.
☒ **GUIDANCE/ADDITIONAL INFORMATION** to provide clarity or explain requirements in detail.

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Guidance when performing valuations of physical non-current assets

Purpose

The purpose of this Policy is to provide practical guidance for valuing physical non-current assets for general purpose financial reporting.

Overview

This guidance summaries existing requirements in TPP21-09 *Valuation of Physical Non-Current Assets at Fair Value* (TPP 21-09) and TD 21-05 *Valuation of Physical Non-Current Assets at Fair Value* (TD 21-05), relating to management revaluations of property, plant and equipment, in those years where a full comprehensive valuation is not required. It also provides some practical tips on how to determine whether a revaluation is required and, if so, an appropriate approach to an interim revaluation.

This guidance does not change the policy and mandatory requirements contained in TPP21-09 and TD 21-05.

Guidance when performing valuations of physical non-current assets

Guidance

1 Conducting a management assessment

TPP21-09 requires management to conduct an assessment as to whether there is any indication that an agency's assets carrying amount differ materially from their fair value.

When performing management assessments, agencies should refer to relevant publicly available sources such as the Australian Bureau of Statistics (ABS) to determine an appropriate change in the value of assets by asset class.

Management assessments are performed to give an indication of the movement in asset values and are used by agencies to decide whether an interim valuation is required and the type of interim revaluation that is required. Therefore, management assessments are not required to be as precise as the interim revaluations that are subsequently performed.

Where management assessments indicate a material difference for a class of assets (in line with audit materiality) an interim valuation must be performed.

Where management assessments indicate an immaterial difference for a class of assets no further work is required.

2 Performing an interim valuation - determine the magnitude of the cumulative change in indicators

Where an interim valuation is determined to be required based on management's assessment, the type of valuation to be performed depends on the magnitude of the cumulative increase/decrease in indicators since the last comprehensive valuation was performed.

The following table summarises the type of valuation to be performed.

Cumulative increases/decreases in indicators/ indices since last comprehensive valuation	Type of valuation to be performed
≤ 20%	*Interim management revaluation to be undertaken* Refer sections 3 - 5 below
> 20%	*Interim formal revaluation to be undertaken*

Cumulative increases/decreases in indicators/ indices since last comprehensive valuation	Type of valuation to be performed
	Refer section 6 below

Clarification

TPP 21-09 requires that an interim formal revaluation be undertaken where there has been a cumulative increase / decrease in indicators / indices generally greater than 20%.

Where the management assessment indicates a cumulative change of 20% or less, an interim management valuation will still be required if the potential change is material.

3 Performing an interim management valuation - determining the appropriate course of action

Where the cumulative increase/decrease in indicators/indices since the last comprehensive valuation is ≤ 20% management should apply their professional judgement to determine the appropriate course of action to be undertaken in relation to performing an interim management revaluation. In applying this judgement management should consider the:

- Magnitude of cumulative changes in indicators since the last comprehensive valuation;
- Estimation uncertainty associated with the asset class;
- Assumptions that management has identified as potentially materially changing fair value;
- Availability of relevant and reliable data; and
- Valuation approach used for the asset class.

The following table provides a guide to determining the appropriate course of action, taking the above factors into account. The table is a guide only and management should apply their professional judgement in balancing each of the factors above, taking into account the specific facts and circumstances.

Magnitude of cumulative changes in indicators	Level of estimation uncertainty[1]	VALUATION APPROACH		
		Cost (replacement or recollection)	Market	Income
Very low	Low/Medium/High	Do nothing	Do nothing	Perform interim management revaluation internally
Low	Medium/High	Perform interim management	Perform interim management	Perform interim management

Magnitude of cumulative changes in indicators	Level of estimation uncertainty[1]	VALUATION APPROACH		
		Cost (replacement or recollection)	Market	Income
		valuation internally	valuation internally	revaluation internally
Moderate	Low/Medium/High	Engage external valuers to assist with interim management valuation	Perform interim management valuation internally	Engage external valuers to assist with interim management valuation
High	Low	Perform interim management valuation internally	Perform interim management valuation internally	Engage external valuers to assist with interim management valuation
High	Medium/high	Engage external valuers to assist with interim management valuation	Engage external valuers to assist with interim management valuation	Engage external valuers to assist with interim management valuation

1. *Refer section 7 for guidance on determining level of estimation uncertainty.*

Once the appropriate course of action has been determined by management this should be discussed with the Audit Office before progressing any further.

4 Performing an interim management valuation internally

When performing an interim management valuation, the indicators/indices used must be relevant and reliable. If management intend to use an index that was used in a prior year (eg an ABS index) management should ensure that the index continues to be appropriate for the asset. This will require management to consider and confirm that there has been no material change in the condition of the asset.

4.1 Approaches to performing management valuation internally

Set out below are some suggested approaches to performing internal management valuations for certain asset classes:

4.1.1 Specialised plant and equipment and infrastructure assets measured under cost approach (at replacement cost)

Management could consider engaging the assistance of external experts to build a valuation spreadsheet that can be maintained by management on an ongoing basis.

When building such a model, management and the external experts could agree on appropriate indices (including blended indices) that are readily obtainable from publicly available sources – for example the Australian Bureau of Statistics (ABS). These indices can be updated in the valuation spreadsheet each time an interim management valuation is required. The use of external valuers can likely be significantly reduced, once the model has been developed.

4.1.2 Specialised buildings measured under cost approach (at replacement cost)

Agencies that employ qualified quantity surveyors could perform desktop valuations on specialised buildings. In such cases, internal quantity surveyors could refer to external sources – including Rawlinson's Construction Cost Guide and the relevant ABS index 3020 for non-residential building construction in New South Wales.

4.1.3 Collection assets measured under market approach

Agencies that employ experts in the relevant collections can perform desktop valuations on collections with reference to comparable recent sales of similar assets.

Please note that the methods above are examples and agencies may have other methods of performing internal management valuations. Where an internal management valuation is required it is recommended that the intended approach be discussed with the Audit Office prior to the valuation being performed.

4.2 Determining whether an adjustment is required

Once an internal management valuation has been performed, management should apply their professional judgement to determine whether an adjustment is required to the carrying amounts of the assets in the asset class.

Management's decision should be formally documented and discussed with the Audit Office.

5 Engaging an external valuer to assist with the interim management valuation

5.1 Approaches to engaging external valuers

Management should apply their professional judgement to determine the appropriate course of action to be undertaken in relation to engaging an external valuer to assist with the interim management valuation.

External valuers may be engaged to provide valuation reports containing indices for use by management in the interim valuation process.

Set out below are some suggested approaches to obtaining valuation reports for such purposes:

5.1.1 Buildings measured under cost approach (at replacement cost)

Valuation reports containing indices for all buildings measured at replacement cost could be obtained from an appropriately qualified valuer. This could be either a private sector valuer or a Government Agency such as Valuation New South Wales on a fee for service basis.

5.1.2 Land measured under market approach

Valuation reports containing indices for all land measured under the market approach could be obtained from an appropriately qualified valuer. This could be either a private sector valuer or a Government Agency such as Valuation New South Wales on a fee for service basis.

5.2 Reviewing the work of the external valuer

Management must conduct and document their review of the external valuation report.

Management reviews should ensure the external valuer's findings are consistent with the Agency's assets and circumstances, make sense and are suitable for the assets reviewed. At a minimum the following should be reviewed by management:

- Methodology and assumptions made by valuers for consistency with instructions provided;
- Assets covered by the report for completeness and accuracy (by comparing to the original list provided to the valuer);
- Reasonableness of inputs and assumptions used by valuer; and
- Movements in indexes, investigating any major changes.

In addition, management should ensure that any restrictions have been properly considered and reflected in the determination of the index.

The outcome of the review should be documented, and where necessary, matters identified during the review should be discussed with the external valuer.

5.3 Determining whether an adjustment is required

If the external valuer has provided an index, once management is satisfied with the work performed by the external valuer, the index should be used by management to estimate the fair value of the assets in the asset class.

Once the fair values of the assets have been established, management should apply their professional judgement to determine whether an adjustment is required to the carrying amounts of the assets in the asset class.

Management’s decision should be documented and discussed with the Audit Office.

6 Performing an interim formal valuation

Where the cumulative increase/decrease in indicators/indices since the last comprehensive valuation is > 20% an interim formal valuation is required (TPP21-09 and TD21-05).

This involves engaging an external professionally qualified valuer to conduct the valuation or to review the valuation performed by management. Depending on management’s assessment, an interim formal revaluation can be replaced with a comprehensive revaluation. A comprehensive revaluation must be performed or reviewed by an external professionally qualified valuer and ordinarily includes an assessment of the physical condition of the assets.

6.1 Reviewing the work of the external valuer

Management must conduct a review of the external valuation report.

Management reviews should ensure the external valuer’s findings are consistent with the Agency’s assets and circumstances, make sense and are suitable for the assets reviewed. At a minimum the following should be reviewed by management:

- Methodology and assumptions made by valuers for consistency with instructions provided;
- Assets covered by the report for completeness and accuracy (by comparing to the original list provided to the valuer);
- Reasonableness of inputs and assumptions used by valuer;
- Sensitivities undertaken by valuer;
- Movements in fair values, investigating any major changes;
- Calculations of the change in fair value (if performed by the valuer).

In addition, management should ensure that any restrictions have been properly considered and reflected in the determination of the fair value.

The outcome of the review should be documented, and where necessary, matters identified during the review should be discussed with the external valuer.

6.2 Determining whether an adjustment is required

Once the fair values of the assets have been established, management should apply their professional judgement to determine whether an adjustment is required to the carrying amounts of the assets in the asset class.

Management’s decision should be documented and discussed with the Audit Office.

7 Determining the level of estimation uncertainty

The level of estimation uncertainty associated with an asset or asset class depends on a number of factors, including the measurement basis used.

7.1 Assets measured under the cost approach

Many assets measured using the current replacement cost method will have a low estimation uncertainty associated with them. Examples include:

- Non-specialised buildings
- Specialised plant & equipment
- Infrastructure

Specialised buildings measured using current replacement cost may have a higher estimation uncertainty due to their unique nature, the fact that they are not traded regularly, their heritage features and/or restrictions placed on their use.

Older assets may have higher estimation uncertainty associated with the challenges of estimating historical costs of construction, identifying modern equivalent components and judgements in the reconstruction of heritage features.

Museum and library collections measured using current replacement costs or recollection costs are likely to have a high estimation uncertainty due to their unique nature and the fact that they are not traded regularly, as well as the fact that their fair values are frequently estimated on a collection basis using sampling techniques. Where sampling techniques are used, external valuers will often disclose a random sampling error percentage in their valuation reports.

7.2 Assets measured under the market approach

The following assets measured under the market approach are assumed to have a low estimation uncertainty associated with them:

- Land without restrictions;
- Non-specialised commercial and residential buildings.

Estimation uncertainty is expected to be higher for assets that have restricted uses due to the market value being determined based on different land and valuer discounts being applied to those values. Examples include:

- National Parks
- Crown Land
- Cemeteries
- Land subject to zoning for hospitals and schools

- Land under roads
- Land under assets under construction

7.3 Assets measured under the income approach

Assets measured under the income approach tend to have a higher estimation uncertainty associated with them due to the variables used in the calculation of discounted cashflows. These variables include prices, volumes, discount rates and terminal values.

Appendix A: Extracts - TPP21-09 Valuation of Physical Non-Current Assets at Fair Value

8.1.3 Interim Revaluations

In years when no comprehensive revaluation is performed, agencies must conduct management assessments (in time for Treasury's mandatory early close procedures) whether there is any indication that an agency's assets carrying amount differs materially from their fair value.

Where management assessments indicate a material difference, an interim revaluation must be performed.

Generally,

- an interim management revaluation should be undertaken when cumulative increases / decreases in indicators/ indices based on the management assessment 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, which could be a full comprehensive inspection, a limited inspection or a desktop assessment, or to review the revaluation performed by management). Depending on management's assessment an interim formal revaluation may be replaced with a comprehensive revaluation.

Interim revaluations may be less detailed than a comprehensive revaluation and should typically involve one or more of the following procedures: indices, desktop valuations using sampling, site visits using sampling and other professional methodologies. The appropriate form of an interim revaluation will depend on:

- The underlying valuation approach for that asset (i.e. cost, market or income);
- The assumptions/inputs that management has identified as potentially materially changing fair value. e.g. discount rates, cash flow projections, market indices;
- The availability of relevant and reliable data; and
- The degree of reliance on specialist knowledge of external valuers.

Examples of assumptions and inputs that may be appropriate for management valuations, include:

- Published indices for each of the key material and labour costs used in determining current replacement cost;
- Published market indices for commercial property in the same location, when using the market approach;
- Assessment of physical, functional and economic obsolescence; and
- Internally prepared cash flow projections based on reliable historical data and external market predictors.

8.2 Fair value indices/indicators

Indicators/indices used in an interim revaluation must be "relevant and reliable"; i.e. they must:

- be appropriate to the class to which it is applied, in terms of location, condition and technological change, where possible; e.g. a general price index such as CPI is not an appropriate index
- have a record of regular publication / availability
- be periodically assessed for appropriateness, including as part of the comprehensive revaluation or interim formal revaluation.

For generalised property (i.e. land and buildings), relevant and reliable fair value indicators should usually be available to the public sector entity. A different index for land and buildings may be required, as land tends to appreciate in value, while the fair value of buildings tends to decline due to depreciation. This includes regularly published indices already available in the market.

For assets other than generalised property, management must refer to appropriate market or other fair value indicators.

If appropriate market or other fair value indicators are not available (e.g. for specialised assets), selection of appropriate indicators must be made in conjunction with, or be subject to the review of, external professionally qualified valuers.

8.5 Management of an asset revaluation

Revaluations, whether they are performed by an independent valuer or by the agency internally, must be reviewed by an appropriately qualified person within the agency to ensure that the revaluations are appropriate before they are relied on or used by the agency.

Appendix B: Extracts - TD21-05 Valuation of Physical Non-Current Assets at Fair Value

vi. An Interim Revaluation of an Agency's Assets:

a. may be performed or reviewed by an external professionally qualified valuer;

b. may be less detailed than a Comprehensive Revaluation and should typically involve one or more of the following procedures: indices, desktop valuations using sampling, site visits using sampling and other professional methodologies;

c. must be performed when a Management Assessment indicates a risk that there is a material difference between the Carrying Amount and the Fair Value of those Assets, unless a Comprehensive Revaluation has been or will be performed in the same year, either:

1. in accordance with cl. 1A(v) of this Direction; or
2. because the Accountable Authority determines, after performing a Management Assessment, that a Comprehensive Revaluation should be performed instead of an Interim Revaluation.

xi. Revaluations, whether they are performed by an independent valuer or by the Agency internally, must be reviewed by an appropriately qualified person within the Agency to ensure that the Revaluations are appropriate before they are relied on or used by the Agency.

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