GUIDELINES ON ACCOUNTING POLICY FOR VALUATION OF ASSETS OF GOVERNMENT TRADING ENTERPRISES

USING CURRENT VALUATION METHODS

STEERING COMMITTEE ON NATIONAL PERFORMANCE
MONITORING OF GOVERNMENT TRADING ENTERPRISES
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PREFACE

The Steering Committee on National Performance Monitoring of Government Trading Enterprises (GTEs) was established at the Special Premiers' Conference in July 1991. Its role is to facilitate the development of a consistent performance monitoring regime for GTEs across the Commonwealth, States and Territories. Through a cooperative effort the Committee has, over the last two years, produced two reports: Government Trading Enterprises Performance Indicators 1987/88 To 1991/92, and 1987/88 To 1992/93.

To ensure that the financial indicators used to assess the performance of GTEs are comparable it was recognised that a consistent approach to the current valuation of assets was required. Accordingly, the Steering Committee established an Asset Valuation sub-Committee in October 1991. This report has been prepared by the sub-Committee. It attempts to provide a framework for consistency in the valuation of non-current physical assets of GTEs involved in national performance monitoring so that relevant, reliable and comparable financial information is available for effective performance monitoring.

The guidelines adopt the concept of 'deprival value' as the appropriate method of valuing the non-financial assets of GTEs. This is a significant departure from the traditional approach of valuing assets at their cost of acquisition (historical cost). Amongst other advantages the sub-Committee recognised that use of deprival value provides more relevant information about both the current cost of providing the goods and services as well as the current value of resources deployed.

The Steering Committee considers that these guidelines represent a significant contribution to the task of meaningful assessment of the performance of GTEs. Jurisdictions are encouraged to adopt this framework to ensure a consistent approach to the valuation of assets.

The Steering Committee would like to thank all those involved in the preparation of this report. In particular it would like to thank Mr Graeme Carpenter, Convenor of the sub-Committee, and the representatives from the Commonwealth, New South Wales, Queensland, South Australia, Tasmania, Victoria, Western Australia, Australian Capital Territory and the Northern Territory. It would also like to thank representatives from the Australian Accounting Research Foundation for their assistance.

Bill Scales, AO
Chairperson
Steering Committee on National Performance Monitoring
of Government Trading Enterprises

GUIDELINES ON ACCOUNTING POLICY FOR CURRENT VALUATION OF ASSETS

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EXECUTIVE SUMMARY

PURPOSE OF THE GUIDELINES

1. The purpose of the Guidelines is to provide the framework to enable a consistent approach to the valuation of non-current physical assets of GTEs involved in national performance monitoring exercise so that relevant, reliable and comparable financial information is available for the effective performance monitoring of GTEs.

APPLICATION OF THE GUIDELINES AND ACCOUNTING STANDARDS AND STATEMENTS OF ACCOUNTING CONCEPTS

2.**Application of the Guidelines**. These Guidelines are to be applied where such application is of material consequence. Information about the performance, financial position or financing and investing activities of a GTE is material if its omission, non-disclosure or misstatement has the potential to adversely affect:

a. decisions about the allocation of scarce resources made by users of the financial report, such as those made by performance monitoring agencies; or

b. the discharge of accountability by the management or governing body of the GTE.

Australian Accounting Standard AAS5, "Materiality in Financial Statements" is to be applied in determining the materiality of particular items or groups of items.

3. Asset values and related expenses permeate nearly all of the proposed financial performance indicators and some non-financial performance indicators. To facilitate valid comparison of the performance of the GTEs and to enable the performance monitoring to be effective, it is essential that these Guidelines be applied consistently to all GTEs and all jurisdictions should adopt these Guidelines and amend existing policies and practices where there is conflict with these Guidelines.

4. **Departures from the Guidelines**. Jurisdictions are to inform the Secretariat for National Performance Monitoring of any planned departures

from these Guidelines and the possible effects of such departures on reported information.

5. **Financial Reporting for Performance Monitoring**. In accordance with the requirements of the relevant jurisdiction, GTEs are to produce either general purpose financial reports or special purpose financial reports for performance monitoring using the asset valuation methodology contained in these Guidelines.

ASSET RECOGNITION AND VALUATION GUIDELINES

6. **Definitions Used in these Guidelines**. Appendix A contains definitions relevant to these Guidelines.

7. **Definition and Recognition of Assets**. GTEs are to adopt the following criteria for the definition and recognition of assets:

a. assets are service potential or future economic benefits controlled by the entity as the result of past transactions or other past events; and

b. an asset shall be recognised in the statement of financial position when and only when:

   (i) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and

   (ii) the asset possesses a cost or other value that can be measured reliably.

8. **Disclosure Where the Recognition Criteria are Not Met**. Where material, details of those assets not recognised in the statement of financial position due to the "reliable measurement" criteria not being met are to be disclosed in the notes to the GTE's financial reports for performance monitoring purposes.

9. **Asset Valuation Methodology**. "Current Value" methodology is to be used as the basis for valuation of GTE assets for performance monitoring purposes.

10. **Reliability and Audit**. To give added value and credibility to the performance indicators, the financial information used as the basis for the indicators is to be subject to external audit.

11. **Compliance with Australian Accounting Standards and Statements of Accounting Concepts**. Within the relevant jurisdiction's legal requirements, GTEs are to either comply with Australian Accounting Standards or Corporations Law and Accounting Standards issued by the Australian Accounting Standard Board and those elements of Statements of Accounting Concepts adopted by these Guidelines.

12. **Consolidated Financial Reporting**. Where applicable, GTEs are to prepare consolidated financial reports in accordance with Australian Accounting Standard AAS24, “Consolidated Financial Reports".

13. **Segment Reporting**. Where applicable, reported information is to be disaggregated by the relevant functions and Australian Accounting Standard AAS16, “Financial Reporting by Segments", is to apply.

14. **Measurement of Asset Values**. Deprival value is to be used as the method of application of current value methodology for assets of GTEs participating in the performance monitoring exercise. Under this approach, assets are valued at an amount that represents the loss that might be expected to be incurred by an entity if that entity were deprived of the service potential or future economic benefits of these assets at the reporting date. Thus the value to the entity in most cases will be measured by the replacement cost of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the replacement cost represents the amount of cash necessary to obtain an equivalent or identical asset.

15. Under this methodology

a. where the service potential or future economic benefits embodied in the asset would be replaced if the GTE was deprived of the asset, the primary bases for valuation of assets are:

   (i) current market (buying) price of a similar asset – where a similar asset can be purchased;

   (ii) current replacement cost of the same service potential or future economic benefits of the existing asset - where a different asset having a similar purpose can be purchased; or

   (iii) current reproduction cost of the same service potential or future economic benefits of the existing asset where the above techniques are not applicable.

b. where the service potential or future economic benefits embodied in the asset would not be replaced if the GTE was deprived of the asset, the basis for valuation of assets is the net present value of the cash flows expected from continued use and subsequent disposal of the asset.

c. surplus assets (that is, assets held for sale without replacement) are to be measured at their current net selling price.

16. **Land**. Land is to be measured consistently with the measurement policies to be applied to other physical assets of GTEs – that is, at deprival value.

17. Land held for continued use is to valued at the greater of:

a. current market buying price, taking into account the nature of the parcel, the legal restrictions on use, the opportunities for and impediments to development that are inherent to the specific parcel of land, other constraints that exist in respect of that land and any special attributes that the land may possess (value in use); and

b. current market value (selling price) based on its feasible alternative use taking account of the costs of achieving that alternative use.

18. Where the service potential of the land would not be replaced if the GTE was to be deprived of it, it should be valued at the net present value of the cash flows expected from continued use and subsequent disposal of the land.

19. Where land is surplus to requirements it should be valued at the current net selling price based on its feasible alternative use.

20. **Land Under Infrastructure**. Land under infrastructure is to be valued (and reported as a separate component of the infrastructure asset) consistently with the measurement policies to be applied to other land and other physical assets of GTEs – that is, at deprival value.

21. **Heritage Assets**. Heritage assets are to be valued consistently with the measurement policies to be applied to other physical non-current assets of GTEs – that is, at deprival value. Classification of assets between those having purely historical or cultural interest and those which also provide a functional service is not relevant to the measurement policies to be applied.

22. Where the service potential embodied in the heritage asset would be acquired (through replacement, reproduction, rental, leasing or in any other manner) if the GTE was deprived of the asset, the deprival value of the asset is the current cost of the service potential or future economic benefits embodied in the asset. Where the service potential of the asset would not be acquired if the GTE was to be deprived of it, the asset should be valued at its recoverable amount,[i.e the greater of the net present value of future cash flows and current market selling price. Normally the appropriate value is the net market selling price if it can be determined reliably with reference to markets for comparable assets.]

22. **General Assets**. Where the service potential or future economic benefits embodied in the asset would be replaced if the GTE was deprived of the asset, general assets are to be valued as follows:

a. where there is a secondary market for the asset (non-specialised assets) - current market buying price of the gross service potential of the existing asset. Where the assets are not normally acquired in a secondary market, the price of a new asset is relevant to determining the value of the asset and where the assets are normally acquired in a secondary market, the

price of a second hand asset is relevant to determining the value of the asset; and

b. where there is no secondary market for the asset (specialised assets) - lower of the current replacement cost or current reproduction cost of the gross service potential or future economic benefit of the existing asset.

24. Where the service potential or future economic benefits embodied in the asset would not be replaced if the GTE was deprived of the asset, general assets are to be valued at the greater of net present value and current market value (selling price).

25. Where a general asset is surplus to requirements it should be valued at the current market value (selling price).

26. **Measurement Methodology Summary**. The bases of measurement are summarised in the following table.

Measurement Bases to be Applied Under these Guidelines to Particular Categories of Physical Non-Current Assets

Asset Category	*Where service potential would be replaced if GTE was deprived of the asset*	*Where service potential would not (or could not) be replaced if GTE was deprived of asset*
Asset Held for Continued Use		
Land (including land under infrastructure)	*The greater of*: Current market buying price, taking into account the nature of the parcel, the legal restrictions on use, the opportunities and impediments to development that are inherent to the specific parcel of land or other constraints that exist in respect of that land, or any special attributes that the land may possess (value in use); and Current market value (selling price) of its feasible potential alternative use taking into account the costs of achieving that potential	Greater of net present value and current market value (selling price)
Heritage assets	Current market buying price, current replacement cost or current reproduction cost, as applicable, of the gross service potential utilised by the GTE if the service potential would otherwise be acquired by the GTE	Greater of net present value and current market value (selling price)
General assets		
– where there is a secondary market for the asset (non-specialised assets)	Current market buying price of the gross service potential of the existing asset - where new assets are normally acquired, new prices are relevant and where second hand assets are normally acquired, second hand prices are relevant	Greater of net present value and current market value (selling price)
– where there is no secondary market for the asset (specialised assets)	Lower of the current replacement cost or current reproduction cost of the gross service potential or future economic benefit of the existing asset	Greater of net present value and current market value (selling price)
Surplus Assets		
All such assets	Not Applicable	Current market value (selling price)

27. **Depreciation**. All non-current assets with limited useful lives ("depreciable assets") are to be depreciated in accordance with Australian Accounting Standard AAS4, “Depreciation of Non-Current Assets", except that the definition of “useful life” set out in Statement of Accounting Practice SAP1, “Current Cost Accounting", is to be applied.

28. **Useful Life**. For the purposes of these Guidelines, “useful life” means “the estimated total period, from the date of acquisition, over which the service potential of the asset is expected to be used up in the business of the entity” (Statement of Accounting Practice SAP1, paragraph 49).

29. **Depreciation Method**. GTEs are to adopt the method of depreciation that most closely reflects the pattern of consumption or loss of the service potential embodied in their depreciable assets. Therefore, no single method of depreciation is prescribed for the depreciable assets of GTEs. The guidance contained in paragraphs 22 to 24 of Australian Accounting Standard AAS4 is appropriate to the selection of the relevant depreciation method for depreciable assets of GTEs.

30. **Revaluation of Assets**. Full revaluations of assets are to be performed at least on a five yearly basis with values being updated in the intervening years by the application of the relevant industry or technological index on an annual basis. The full revaluations may be performed on a rolling basis to even out the work load and demand for resources.

31. **Asset Capitalisation and Revaluation Thresholds**. Each GTE is to set:

a. a Capitalisation Threshold, being the value above which items are capitalised as assets; and

b. a Revaluation Threshold being the value and/or useful life above which assets are to be revalued in accordance with these Guidelines.

32. GTEs are to set their own thresholds within the policies of the relevant jurisdictions. The relevant value for the application of the thresholds is the fair value of the asset at the time of acquisition of control. If this is not known for assets acquired before these Guidelines applied, the GTE can utilise the deprival value adopted on the application of these Guidelines.

33. **Grouping of Similar Assets**. Where a GTE controls a large number of similar assets with individual values below the capitalisation threshold but which, when grouped together, represent a value which is a significant percentage of the total asset value, the GTE, having regard to materiality, should consider grouping those assets for the purpose of capitalisation.

34. **Recording of Asset Values**. The current value of the gross service potential or future economic benefits of assets is to be recorded in the GTE's records.

35. **The Recoverable Amount Test**. The recoverable amount test is only to be applied where the GTE is a profit seeking organisation and to a physical non-current asset of such a GTE when, and only when, the service potential of the asset is dependent on its ability to generate net cash inflows from the goods and services provided.

36. **Disclosure of the Initial Application of the Recoverable Amount Test**. Where the recoverable amount test is applied, the effects of the initial application of the test are to be disclosed in the notes to the statement of financial position.

37. **Reporting of Asset Values**. Where the recoverable amount test does not apply, for assets with infinite useful lives, the gross value of the service potential or the future economic benefits embodied in the asset is to be reported in the GTE's statement of financial position. For assets with a limited useful life, the written down value of the asset is to be reported in the GTE's statement of financial position.

38. Where the recoverable amount test applies, for assets with infinite useful lives, the lesser of the gross value of the service potential or the future economic benefits embodied in the asset and the recoverable amount is to be reported in the GTE's statement of financial position. For assets with a limited useful life, the lesser of the written down value of the asset and the recoverable amount is to be reported in the GTE's statement of financial position.

39. **Instructions to Valuers**. To achieve consistency in valuation, jurisdictions should ensure that any instructions to valuers embody the principles set out in the model Letter of Instruction contained in Appendix B.

40. **Identification of Relevant Costs on Acquisition of Assets**. The provisions of Australian Accounting Standard AAS21, "Accounting for the Acquisition of Assets (including Business Entities)", are to be applied when determining the value of an asset when acquired.

41. **Contributions by External Parties**. Where a GTE has received contributions towards assets from external parties either by way of direct contribution of an asset or some up front payment to allow the GTE to either purchase or construct the asset, the asset is to be recognised as an asset of the GTE if it meets the criteria adopted by these Guidelines and brought to account at its fair value at the date of acquisition.

42. The question as to the appropriate pricing regime adopted by a GTE with respect to such assets is beyond the scope of these Guidelines and is a matter for individual GTEs and their respective Governments. In some cases, the GTE may wish to provide compensation to the user of an asset through lower prices than would otherwise be commercially appropriate to reflect the fact that the user has contributed in part or in full towards the purchase or construction of an asset. However, it is clear that the fact that an asset is funded by an external party in no way affects the methodology adopted with respect to recognition and valuation of that asset.

43. **Finance Costs**. Interest and other finance costs incurred in the process of acquiring the service potential or future economic benefits embodied in an asset are to be included in the value of an asset when those costs can be reliably attributed to the existing asset.

44. **Assets Constructed by the GTE for Use in its Operations**. Paragraphs 14 and 15 of Australian Accounting Standard AAS11, "Accounting for Construction Contracts", are to be used as a guide when identifying the costs associated with the construction of an asset by a GTE for use in its own operations.

45. **Restricted Assets**. Where the uses of assets recognised in the statement of financial position are restricted by legislation, directives or other external means and those restrictions are relevant to assessments of the performance, financial position or financing or investing of the GTE, disclosure is to be made of:

a. the values of those assets; and

b. the nature of those restrictions.

46. **Controlled Items**. GTEs should establish systems to ensure adequate management of items with a value below the capitalisation threshold which, because of their attractiveness and portability, are more liable to be misplaced or stolen.

47. **Renewals Accounting**. "Renewals accounting" is not permitted in relation to reporting for GTE performance monitoring purposes.

48. **Capitalisation and Maintenance Expenditure**. Expenditure on an existing non-current asset is to be capitalised only when it is material and produces an effective increase in the present or planned service capacity of the asset which will be utilised or an effective increase in the quality of the asset's services or effectively extends the useful life of the asset. Other expenditure on repairs and maintenance is to be classified as expenses except where the expenditure is material and is in respect of maintenance scheduled to occur less frequently than once a year or scheduled maintenance that has been deferred

beyond year end in which case it is to be accounted for in accordance with paragraph 49 of these Guidelines.

49. **Future and Deferred Maintenance**. Where major cyclical maintenance is scheduled (in accordance with a maintenance program) over a number of reporting periods or maintenance is deferred to future reporting periods, the depreciation expense (or provision for major periodic maintenance expense if applicable) recognised during each reporting period until the maintenance is performed is to take into account the consumption or loss of service potential or future economic benefits. When the cyclical or deferred maintenance is carried out the accumulated depreciation (or provision for major periodic maintenance) is to be adjusted by the amount of the cost of the restoration. Expenditure in excess of the amounts that have been charged as depreciation or provision for major periodic maintenance expense are to be reported as a maintenance expense in that period.

50. **Disclosure of Deferred Maintenance**. The amount of future maintenance expenditure arising from a deferral of previously planned maintenance expenditure is to be disclosed by way of note. The note is to include the details of any projected material effect on the future capacity or useful life of the asset or assets.

51. **Classification of Assets**. Except for those classifications discussed earlier, no specific classification of assets is required. However, the provisions of Australian Accounting Standard AAS10, “Accounting for the Revaluation of Non-Current Assets", are to be applied.

52. **Accounting for Shared Assets**. Each asset is to be reported by the entity that has prime control of the service potential or future economic benefits embodied in the asset. Where it can be argued that no one entity has prime control of an asset since all have equal control and ownership interests, the entities are to ensure that the asset is reported by one of the entities.

53. **Disclosure Requirements**. In addition to the disclosures specified in Australian Accounting Standards the following summarises the disclosures required in the notes to GTE financial reports for performance monitoring purposes:

a. the asset capitalisation and revaluation thresholds adopted;

b. in respect of each class of asset:

   (i) the effects of the initial application of the recoverable amount test where the test is first applied under these Guidelines;

   (ii) where the use of assets recognised in the statement of financial position are restricted, wholly or partially by legislation, government

directives or other external means and those restrictions are relevant to assessments of the performance, financial position or financing or investing of the GTE, disclosure is to be made of the value of those assets together with the details of the nature of those restrictions;

(iii) deferred maintenance expenditure including the projected material effect on the assets future capacity or useful life;

(iv) details of those assets not recognised in the statement of financial position due to “reliable measurement” criteria not being met; and

(v) where a parcel of land held for continued use (that would be replaced) is included in the statement of financial position at its 'current market value' (based on its feasible alternative use) and this is materially greater than its deprival value, both values of that land must be disclosed in a note.

54. **Implementation Issues**. In adopting these Guidelines, the Commonwealth, State and Territory Governments need to recognise the requirement for technical assistance and adequate resources and assistance to enable their effective adoption.

EXPLANATORY PAPER

INTRODUCTORY SUMMARY

PURPOSE OF THE EXPLANATORY PAPER

55. This Explanatory Paper has been prepared to outline the asset valuation and related accounting Guidelines to be adopted by government trading enterprises (GTEs) as part of the national system of monitoring their performance. It also includes background discussion on how the Guidelines were developed and how they should be applied.

56. **Structure of the Explanatory Paper**. Each section following discusses a major topic and, where necessary includes the relevant Guideline(s) for that topic

57. **The Valuation Guidelines**. The Sub-Committee has developed Guidelines for the valuation of non-current assets. These are set out in detail in the following section of this Paper. In summary specific Guidelines have been developed on the following issues:

- Application of the Guidelines,
- Departures from the Guidelines,
- Financial reporting for performance monitoring,
- Definition and recognition of assets,
- Disclosure where the recognition criteria are not met,
- Asset valuation methodology,
- Reliability and audit,
- Compliance with Australian Accounting Standards and Statements of Accounting Concepts ,
- Consolidated financial reporting,
- Segment reporting,
- Measurement of asset values,
- Land,
- Land under infrastructure,

- Heritage assets,
- General assets,
- Measurement methodology summary,
- Depreciation,
- Useful life,
- Depreciation method,
- Revaluation of assets,
- Asset capitalisation and valuation thresholds,
- Grouping of similar assets,
- Recording of asset values,
- The recoverable amount test,
- Disclosure of the initial application of the recoverable amount test,
- Reporting of asset values,
- Instructions to valuers,
- Identification of relevant costs on acquisition of assets,
- Contributions by external parties,
- Finance costs,
- Assets constructed by the GTE for use in its operations,
- Restricted assets,
- Controlled items,
- Renewals accounting,
- Capitalisation and maintenance expenditure,
- Future and deferred maintenance,
- Disclosure of deferred maintenance,
- Classification of assets,
- Accounting for shared assets,
- Disclosure requirements, and
- Implementation issues.

BACKGROUND

58. GTEs are government agencies that provide goods and services directly to the community. As GTEs employ and control a significant proportion of the nation's resources, considerable attention has been focussed in recent years on the need to improve the performance of these agencies. The efficiency and

effectiveness with which these resources are deployed is fundamental to the nation's economic performance and to assisting in many areas of its international competitiveness.

59. The July 1991 Special Premiers' Conference recognised that, "*Government Trading Enterprises use a significant quantity of the nation's resources. The efficiency with which these resources are deployed is fundamental to the nation's economic performance and to assisting in many areas our international effectiveness."* The Conference "*agreed that a framework for national performance monitoring be established for GTEs*."

60. It was also agreed that:

"*At the State/Territory level the enterprises will include those involved in energy, rail, water, major ports and urban public transport. Commonwealth enterprises to be covered include Telecom/OTC, Australia Post, Australian National Line, the Federal Airports Corporation and the Pipeline Authority. This core group will be expanded progressively once the system is operational and may, in due course, extend to Local Government enterprises.*

A range of performance indicators are to be used including accounting, economic and non-financial indicators. The focus initially will be on providing accounting and non-financial measures of performance.

The Industry Commission, under the auspices of a Commonwealth-State Steering Committee, is to prepare a preliminary version of national performance indicators for 1990-91 concentrating on accounting and non-financial measures of performance.

The Steering Committee will consider:

- preparation and publication of performance indicators for 1991-92 by the end of 1992; and
- the appropriate agency to undertake the task on an on-going basis.

In the meantime, the Public Sector Accounting Standards Board and other bodies are to be requested to give priority to refining national accounting standards for GTEs, including standards for asset valuation."

61. Resulting from this the Steering Committee on National Performance Monitoring of GTEs was established comprising representatives of the Commonwealth, each State and Territory. The Industry Commission provided a secretariat.

62. Governments have nominated 56 GTEs within their respective jurisdictions to be included in the performance monitoring activity. Appendix C contains details of these GTEs. The Steering Committee has developed

financial (accounting and economic) and non-financial indicators and agreed that it "*should establish a technical group to survey current practice and to develop a consistent set of guidelines for asset valuation*".

63. A Sub-committee on Asset Valuation was subsequently established at the request of the Steering Committee at its meeting held on 3rd October 1991, consisting of senior officers from each Government. Assistance was provided by the Australian Accounting Research Foundation. This Paper was prepared by the Asset Valuation Sub-Committee.

VALUATION OF GOVERNMENT TRADING ENTERPRISE ASSETS

64. **Objectives of the Task**. One means of improving the efficiency of GTEs is to subject them to a regime of on-going performance monitoring. The proper determination of certain of the financial indicators adopted by the Steering Committee (e.g. return on assets, return on equity etc) calls for the urgent resolution of a number of issues associated with asset valuation, depreciation and maintenance. Apart from their implications for the calculation of rates of return, estimates of values of assets and the periodic costs of their usage can have an important influence on capital investment decisions as well as pricing policies in relation to the provision of goods and services to the public.

65. The Asset Valuation Sub-committee was established "*to prepare a set of consistent guidelines for the valuation of assets in GTEs"*. Discussions have resulted in the Sub-committee focussing on valuation of non-current physical assets as they have the greatest impact on the performance indicators and present the most difficulty in determining the most relevant asset valuation methodology.

66. **Scope of Asset Types**. The GTEs identified by the Steering Committee for initial inclusion in the monitoring exercise include entities from the Commonwealth and all States and Territories. They are engaged in such diverse areas as electricity generation, transmission and distribution, water supply, sewerage and drainage, rail, tram and bus passenger transport, rail freight, transport, port provision; gas transmission and distribution; irrigation; communications provision; shipping services; airport provision; and pipeline transport. Consequently a wide variety of asset types are held by these GTEs.

67. **Valuation of Current Assets and Non-Physical Assets**. The valuation methodology developed by the Sub-committee and contained in the Guidelines herein specifically addresses non-current physical assets. The following provides a brief resume of accounting pronouncements and guidance releases to

assist in establishing appropriate accounting treatment for current assets and non-current non-physical assets:

a. Identifiable Intangible Assets. Items such as patents and brand names are able to be identified as having value. There is no specific guidance on accounting for these assets following the withdrawal of Exposure Draft 49. The appropriate accounting treatment for intangibles in individual cases will have to be developed from the relevant accounting pronouncements that are available. These include:

   - Statement of Accounting Concepts SAC4, “Definition and Recognition of the Elements of Financial Statements";
   - Australian Accounting Standard AAS4, “Depreciation of Non-Current Assets";
   - Australian Accounting Standard AAS10, “Accounting for the Revaluation of Non-Current Assets"; and
   - Australian Accounting Guidance Release AAG5, “Accounting for Intangible Assets Recognised in Accordance with Statement of Accounting Standards AAS 18".

a. Unidentifiable Intangible Assets. Guidance on the accounting treatment for Goodwill is found in Australian Accounting Standard AAS18, “Accounting for Goodwill".

b. Marketable Securities. These are those securities which are quoted on the stock exchange such as, shares, bonds, notes and debentures and which may be held as trading stock or as non-current assets. Guidance is found in:

   - Australian Accounting Guidance Release AAG9, “Accounting for Marketable Securities in the Context of Statements of Accounting Standards, AAS2 and AAS10";

     Australian Accounting Standard AAS2, “Measurement and Presentation of Inventories in the Context of Historical Cost System"; and
   - Australian Accounting Standard AAS10, “Accounting for the Revaluation of Non-Current Assets".

d. Non Marketable Securities. These are securities which are not traded. Guidance is found in Exposure Draft 59, “Financial Instruments".

e. Inventories. Guidance is found in AAS2, “Measurement and Presentation of Inventories in the Context of Historical Cost System".

f. Monetary Assets and Liabilities. Guidance is found in Australian Accounting Guidance Release AAG10, “Measurement of Monetary Assets and Liabilities".

g. Research and Development. Guidance is found in Australian Accounting Standard AAS13, “Accounting for Research and Development Costs".

Further detail in respect of these is found in Appendix E.

68. **Performance Indicators**. The prime purpose of the national performance monitoring of GTEs activities is the provision to Government owners, of relevant and reliable information that can be compared across jurisdictions to assess the relative efficiency of like enterprises.

69. Asset values impact upon almost all of the financial and a number of non-financial performance indicators the Steering Committee developed. Appendix D contains a description and summary of the purpose and construction of all of the relevant performance indicators and in each case sets out the relationship of asset values to the indicator.

APPLICABILITY OF THE GUIDELINES

COMPLIANCE WITH THE GUIDELINES

70. For the performance monitoring exercise to be effective it is essential that all Governments implement measures that require GTEs to comply with these Guidelines. If this is not done, the information supporting the performance indicators will not be prepared on a consistent basis and the results may be misleading and not comparable.

Guidelines

71. These Guidelines are to be applied where such application is of material consequence. Information about the performance, financial position and financing and investing activities of a GTE is material if its omission, non-disclosure or misstatement has the potential to adversely affect:

a. decisions about the allocation of scarce resources made by users of the financial report, such as those made by performance monitoring agencies; or

b. the discharge of accountability by the management or governing body of the GTE.

Australian Accounting Standard AAS5, "Materiality in Financial Statements" is to be applied in determining the materiality of particular items or groups of items.

72. Asset values and related expenses permeate nearly all of the proposed financial performance indicators and some non-financial performance indicators. To facilitate valid comparison of the performance of the GTEs and to enable the performance monitoring to be effective, it is essential that these Guidelines be applied consistently to all GTEs and all jurisdictions should adopt these Guidelines and amend existing policies and practices where there is conflict with these Guidelines.

73. Jurisdictions are to inform the Secretariat of any departures from these Guidelines and the possible effects of such departures on reported information.

DEVELOPMENT AND STATEMENT OF THE GUIDELINES

OBJECTIVES OF FINANCIAL REPORTING

74. **Types of Financial Reports**. Asset values and expenses are included in several different types of financial reports and the decisions that users of the reports are required to make is the principal determinant of the valuation methodology that is used. There are two basic types of financial reports, general purpose financial reports and special purpose financial reports.

75. **General Purpose Financial Reports**. Statement of Accounting Concepts SAC2, "Objective of General Purpose Financial Reporting" indicates that general purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources. The Statement also indicates that managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability and that the reports shall disclose information relevant to the assessment of performance, financial position, and financing and investing, including information about compliance.

76. General purpose reports are prepared for users who cannot command special purpose reports tailored to their individual needs. They are the financial reports included in published annual reports of reporting entities and are required to:

a. provide information useful to users for making and evaluating decisions about the allocation of scarce resources;

b. be presented by management in a manner which assists in discharging their accountability; and

c. disclose information relevant to the assessment of performance, financial position, and financing and investing, including information about compliance.

77. The requirement to report for different purposes can result in the application of different asset valuation methods and, in its consideration of the valuation methodology, the Sub-committee has taken into account the fact that the information is to be used for performance monitoring.

78. The range of decisions made by users of general purpose financial reports may not always be able to be facilitated from a single basis of valuation. In an attempt to acknowledge this, alternative valuations to those used in the general purpose financial reports can be given in supplementary notes to the statement of financial position (e.g. the Corporations Law permits assets to be shown at historical cost in the balance sheet, but requires notes giving recent valuations of

land and buildings and, for listed companies, the Australian Stock Exchange requires notes giving market values of certain investments).

79. **Special Purpose Financial Reports**. Special purpose financial reports are prepared for management or other persons or bodies having the authority to demand those reports and to specify the form of their presentation. Such reports include:

a. Reports prepared for management for operational purposes covering such areas as revenue, production costs, financial position and cash flows. Such reports would typically be used for decisions concerning resource allocation, cost control, pricing, liability containment, control of inventories and debtors and managing cash flows;

b. Some kinds of reports prepared for management may be more likely to be concerned with economic or market values of assets. For example, they may be used for renting or leasing decisions, decisions about disposal or purchase of assets, borrowing and investment decisions, compulsory purchase by a public authority, property taxation, insurance, feasibility studies, disclosing financial position in a prospectus and corporatisation of a public sector activity;

c. Reports prepared for bodies such as the Reserve Bank, Office of the Insurance Commissioner, various State and Territory authorities (including the taxation authorities) and the Australian Stock Exchange. In addition, Ministers or government departments may require reports to enable monitoring of the performance or the financial position of Government Trading Enterprises throughout the financial year. In each case the methods of valuing assets included in such reports is dependent upon the decisions that the users are required to make; and

d. Reports prepared for receivers and liquidators.

80. **Financial Reporting for Performance Monitoring**. The performance monitoring requirements can be met through either general purpose financial reports or special purpose financial reports. The Sub-committee recognises that it is each jurisdiction's prerogative as to the approach which it adopts for its general purpose financial reports and each will therefore need to take a decision as to whether the performance monitoring requirements are in fact addressed through general purpose financial reports or special purpose financial reports.

81. Notwithstanding the type of reporting, reliable information on assets, liabilities and equity at the end of each accounting period, together with information on revenues and expenses, is clearly important in order to assist in the assessment of the financial performance of the entity over the reporting period. This information is also useful in calculating the cost of providing

goods and services and the change in the entity's control over resources during the reporting period.

Guideline

82. *In accordance with the requirements of the relevant jurisdiction, GTEs are to produce either general purpose financial reports or special purpose financial reports for performance monitoring using the asset valuation methodology contained in these Guidelines.*

CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

83. For financial information to be useful, it must possess the characteristics of relevance, reliability, comparability and understandability. It was with this in mind that the asset valuation methodology in these Guidelines has been developed.

84. Relevance is one of the primary characteristics of information. For information to be relevant, it must relate to the particular purpose for which it is to be used, as only information that is relevant to a user's needs is useful. Information that is not relevant can be misleading and result in incorrect decisions being made. At best, irrelevant information is recognised as having no benefit and should be discarded.

85. Reliability, the other primary qualitative characteristic, requires faithful representation, neutrality and verifiability. Only current value information will fulfil these criteria, as other bases do not represent the asset in today's values and are biased as a result of changes in value due to inflation or technological change.

86. Comparability requires that information can be related to other information and for this to be possible, information must be measured and reported in a consistent manner. Comparability also requires that consistent sets of accounting principles, definitions, assumptions, data processing and measurement techniques, classifications of data and reporting intervals are applied uniformly throughout the recording and reporting systems.

87. Understandability requires that information be reported in a form that can be readily understood by a reasonably competent user.

DEFINITION AND RECOGNITION OF ASSETS

88. **Definition of Assets**. The Sub-committee has been guided by the Statements of Accounting Concepts when considering the nature of assets. Accordingly it has adopted the concept of an asset as "service potential or future

economic benefits controlled by the entity as a result of past transactions or other past events".

89. To be defined as such, an asset must embody the following three essential characteristics:

a. *Service Potential or Future Economic Benefits.* This characteristic, which can be described as the inherent capacity of assets to provide services or benefits to the entities that use them, is common to all assets irrespective of their physical or other form;

b. *Control by a Particular Entity.* This relates to the capacity of the entity to benefit from the asset in pursuit of its objectives and to deny or regulate the access to others of that benefit. It is to be noted that this concept does not require an entity to own or physically possess an asset but it is necessary that the entity is able to control or deny access to the "service potential or future economic benefits" embodied in the asset; and

c. *Occurrence of a Past Transaction or Past Event.* The transaction or other event giving the entity control over the service potential or future economic benefits must have occurred. This characteristic differentiates assets from items which are only "potential" assets and which are not to be recognised as assets by an entity. Although, in most cases, entities gain control of the benefits of assets by cash or barter transactions, other assets are gained by means of non-reciprocal transactions (e.g. donations, grants etc) and this criterion does not limit the acquisition of assets to "exchange" transactions.

90. Assets generally have a number of other characteristics, such as acquisition at a cost to the entity, tangibility, exchangeability, and legal enforceability. However, these are not essential characteristics and the absence of any or all of them is not sufficient to preclude an item from qualifying as an asset.

91. The Sub-committee decided not to require the recognition of assets arising from Agreements Equally and Proportionately Unperformed (AEPUs) (as explained in the Appendix to SAC4) other than those arising from agreements covered by an existing standard. The Sub-committee notes that the AASB and PSASB have SAC4, including AEPUs, currently under review.

92. **Service Potential or Future Economic Benefits**. In following their set objectives, profit-seeking and not-for-profit entities create utility and value in essentially the same way - they use assets to provide goods and services that their customers or beneficiaries desire or need. Thus, assets provide a means for entities to achieve their objectives.

93. In all profit-seeking entities, the service potential or future economic benefits of assets are used to provide goods and services to generate net cash

inflows. This may be from the sale of an asset with service potential or future economic benefits, or the sale of the outputs produced through use of the asset. Net cash inflows may include reductions in cash outflows, such as lower costs of production resulting from an entity's research and development efforts. However, it must be noted that a number of expenditures and other events which result in reduced future cash outflows do not give rise to service potential or future economic benefits and do not qualify as assets. An example is redundancy payments to employees which avoid cash outflows in the future in respect of those employees. These payments would not give the employer the future services from the employees, do not result in service potential or future economic benefits for the entity and therefore do not give rise to assets.

94. In not-for-profit entities, the service potential or future economic benefits are also used to provide goods and services in accordance with the entity's objectives. The provision of goods and services may often not result in net cash inflows to the entities as there may be little or no consideration given by the recipients. This does not deprive those outputs of utility or value nor does it preclude the entity from benefiting from the assets used to provide the goods and services. For example, monuments, museums, cathedrals and historical treasures provide needed or desired services to beneficiaries, normally at little or no direct cost to those beneficiaries and provision of these assets benefit the providing entities by enabling them to meet their objectives.

95. Cash on hand and on deposit is of benefit to an entity because of the command over service potential or future economic benefits it provides through its convertibility. Some assets, such as debtors and investments, are direct claims to cash inflows which are expected to occur when the entity receives payments for accounts, interest or dividends or when an investment is sold. Prepayments are assets because they represent existing rights to receive services. Other assets may provide benefits to the entity through their exchange for cash, cash equivalents or other goods and services (for example, inventories for sale), they may be used for the provision of goods or services (for example, land and buildings, plant and equipment, patents) or they may be used for settling liabilities.

96. The definition of an asset refers to the actual services or benefits and not the source object or right. Without service potential or future economic benefits, an object or right will not provide any service or benefits to an entity and will not therefore qualify as an asset. Thus, an assumption that a particular type of object or right will always be an asset is not valid. For example, while a machine would normally provide service potential or future economic benefits, it may become obsolete or unusable and have no scrap value and would cease to qualify as an asset. Also, because of specific business or contractual

arrangements, service potential or future economic benefits expected from objects or rights may be shared by more than one entity. For example, each party to a joint venture may have an interest, as tenant in common, in each of the objects or rights committed to the joint venture and would recognise as assets their respective shares of the outputs from the objects or rights. Also, lease agreements give the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value, both of which are considered to be service potential or future economic benefits.

97. **Control by a Particular Entity**. The entity controlling an asset has the exclusive right, depending on the nature of the asset, to exchange it, use it to provide goods or services, exact a price for others' use of it, use it to settle liabilities, hold it, or perhaps distribute it to owners. An asset is specific to an entity in that it is the asset of only one entity at one time except through the control of the entity by another entity. In these circumstances, the asset would be included both in the financial report of the entity with direct control of the asset and in the financial report of the economic entity comprising the controlled and parent entities.

98. The capacity of an entity to control the service potential or future economic benefits normally stems from legal rights. However, legal enforceability of a right is not a necessary condition for the establishment of control over the service potential or future economic benefits, since an entity may be able to control the service potential or future economic benefits expected to flow from a particular item or activity in another way. For example, the outcome from research and development activities may qualify as an asset where the entity is able to control the service potential or future economic benefits embodied in a particular product formula or production process by maintaining secrecy.

99. Possession or ownership of an object or right would normally indicate control over the service potential or future economic benefits embodied in the object or right but these are not essential characteristics of an asset. An entity may possess an object or right but not expect to enjoy the services or benefits embodied in it. For example, an agent may hold goods for sale on behalf of a principal. Conversely, an entity may not physically possess an object or right but may expect to enjoy its services or benefits.

100. Also, an entity may control an object or right but not own it. For example, under a lease agreement, control over the leased property owned by the lessor is transferred to the lessee (although the extent and duration of control will vary according to the terms of the agreement). Conversely, an entity may own an object or right but not control it.

101. Where an entity is not able to deny or regulate the access of other entities to the objects or rights in which the service potential or future economic benefits

are embodied, the service potential or future economic benefits will not be controlled by the entity. For example, public highways represent service potential or future economic benefits to the entities that use them, but do not qualify as assets of entities other than those responsible for their operation. This is because the entities that use the highways are unable to control access to them by other entities. Similarly, general access to air or water does not qualify as assets of the entities that use them, even if they have incurred costs to help clean the environment.

102. The concept of control allows emphasis to be given to economic and social sanctions where they may be effective in influencing entities to meet commitments or to comply with widely accepted business practices or customs. Thus, inclusion of a control test rather than a legal enforceability test in the definition of assets means that the definition is more flexible in assessing the capacity of an entity to gain the service potential or future economic benefits.

103. **Occurrence of Past Transaction or Other Past Event**. The requirement for the occurrence of a past transaction or event enables the distinction between the service potential or future economic benefits of present and future assets of the entity. Service potential or future economic benefits that are not controlled at the present time do not qualify as assets. Thus, a decision prior to the reporting date to acquire a new productive facility does not create an asset for the entity, even though there may be a high probability that the entity will acquire the facility and enjoy the service potential or future economic benefits embodied therein. However, if the entity had, as at the reporting date, entered into an firm contract with another entity to acquire the facility, a right may have been obtained and, consequently, an asset created.

104. **Other Characteristics of Assets**.

a. *Acquisition at a Cost.* Assets are normally acquired at a cost incurred by the entity but cost incurrence is not a necessary condition for the existence of an asset. While it may provide evidence of the existence of service potential or future economic benefits, it is not conclusive proof since costs may be incurred without obtaining service potential or future economic benefits. Equally, as noted above, an asset may be obtained without a cost attached.

b. *Tangibility.* Tangibility is not an essential asset characteristic as assets such as receivables, prepayments, patents, trademarks and goodwill can all embody service potential or future economic benefits, even though they do not have physical substance. Also not all objects possessing physical form will meet the definition of assets. As explained above, it is the presence of service potential or future economic benefits, not the physical or other

form of an object or right, that is relevant in assessing whether an asset exists.

c. *Exchangeability.* This means that an item is separable from the entity and has a separate disposal value. This is not a necessary condition for an asset, as service potential or future economic benefits are not precluded because an asset cannot be separated from the entity, nor are they necessarily related to the existence of a present disposal value. Work in process and specialised plant and equipment may have zero or negligible disposal values but, as part of a productive process, they can provide substantial service potential or future economic benefits to the entity. Also, while goodwill can not normally be separated from an entity, it meets the definition of an asset since it comprises the service potential or future economic benefits embodied in unidentifiable assets. Unidentifiable assets (which are those items which possess the essential characteristics of assets but are not capable of being individually identified) would usually include market penetration, effective advertising, good labour relations, superior management and a highly skilled workforce. Although exchangeability is not an essential asset characteristic, the existence of a separate disposal value may provide evidence of the existence of service potential or future economic benefits.

d. *Legal Enforceability.* While the ability of an entity to exercise control over the service potential or future economic benefits will often stem from the existence of legally enforceable rights, the absence of legal ownership does not preclude the existence of control. For example, an entity may protect the service potential or future economic benefits embodied in a formula or an invention not by applying for a patent but by maintaining secrecy. Similarly, the presence of legal rights does not guarantee control. For example, goods may be sold subject to reservation of title, whereby a stipulation is placed in a sale of goods agreement to the effect that ownership of the goods does not pass to the buyer until the time of payment. The substance of these arrangements is that the buyer effectively has control over the service potential or future economic benefits embodied in the delivered goods unless there is an incapacity to pay. The seller, while possessing legal title and therefore the right to resume possession in the event of the buyer's default, does not control the service potential or future economic benefits embodied in the goods. Another example is where a government entity, such as a government department, does not have legal ownership of the buildings in which it operates, such ownership vesting in another government entity, but controls the service potential or future economic benefits embodied in the buildings because of

the terms of a particular government policy, ministerial directive or administrative arrangement.

105. **Recognition of Assets**. Once an asset is identified, it is necessary that it be assessed according to certain criteria for recognition in the financial reports. Consistent with developments in the accounting profession, the Sub-committee considers that the following criteria are the most relevant for recognition of assets:

(a) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured reliably.

106**. Probable Service Potential or Future Economic Benefits**. For an asset to be recognised it must be probable that the service potential or future economic benefits will eventuate which means that the chance of the service potential or future economic benefits arising is more likely rather than less likely. "Probable" is used in these Guidelines with its usual meaning and refers to that which can be expected on the basis of available evidence or logic.

107. Assessments of the degree of probability of benefiting from the service potential or future economic benefits in any particular situation are made on the basis of available evidence. An amount receivable, due for settlement shortly after the reporting date and owed by a reputable entity, may not be received if the debtor suddenly suffers from severe financial problems after the reporting date. Nonetheless, at the reporting date, the likelihood of non-receipt is remote and the receivable would be recognised as an asset of the entity.

108. Where an expenditure has been made but it is not considered probable at that time, that service potential or future economic benefits will flow to the entity, an asset is not recognised by an entity. This does not imply that management's intention in making the expenditure was not to generate service potential or future economic benefits or that, in making the expenditure with this intention, management was misguided or that the item fails to satisfy the definition of an asset. On the basis of the available evidence at the time of payment, the only implication is that the necessary degree of certainty for the item to be recognised as an asset does not exist. For example, service potential or future economic benefits arising from some research and development expenditure may not be recognised as an asset because, at the date of the expenditure, it is not possible to establish that it is probable that service potential or future economic benefits will eventuate.

109. An asset which, at a particular point in time, fails the test of probable service potential or future economic benefits may qualify for recognition as an asset at a later date as a result of subsequent transactions or other events. Where

this occurs, the asset would be recognised when it qualifies, even though this may involve amounts that had previously been recognised as expenses by the entity. For example, where an entity which has recognised exploration costs in relation to a particular area of interest as expenses, subsequently confirms the existence of a valuable mineral deposit.

110. **Reliable Measurement**. For an asset to be recognised by an entity it is necessary that it possess a cost or other value that can be measured reliably. The term "reliably" is used in these Guidelines with the meaning corresponding to that given to the term "reliability" in Statement of Accounting Concepts SAC3, "Qualitative Characteristics of Financial Information".

111. The appropriate measurement basis for an asset will depend upon the model of accounting being applied. In most cases, assets will have a cost or other value that can be measured reliably in accordance with the particular accounting model. However, in some cases an item may not possess a cost or other value that can be measured reliably and would not therefore qualify for recognition under any of the models. For example, a mining company may have discovered, at immaterial cost, evidence of minerals at one of its exploration sites, but not be in a position as at the reporting date to know the extent of the find or its value. Thus, the company would not be able to recognise, under any accounting model, an asset representing the minerals.

Guideline

112. GTEs are to adopt the following criteria for the definition and recognition of assets:

a. *assets are service potential or future economic benefits controlled by the entity as the result of past transactions or other past events; and*

b. an asset shall be recognised in the statement of financial position when and only when:

   (i) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and

   (ii) the asset possesses a cost or other value that can be measured reliably.

113. **Disclosure Where the Recognition Criteria are Not Met**. Assets that are not recognised by an entity because it is not considered probable that service potential or future economic benefits will flow to the entity will warrant disclosure in the notes in the financial report where knowledge of the assets is considered to be relevant to the users of the financial report. For example, expenditure on computer software development may meet the definition of an asset and the recognition criterion of reliable measurement, but may fail to be

recognised as an asset because it does not satisfy the recognition criterion of the probability of occurrence of service potential or future economic benefits. However, information about the asset may be considered to be relevant to the users of the financial report in making and evaluating decisions about the allocation of scarce resources and may warrant disclosure in the notes to the financial statements.

114. Assets that are not recognised solely because they do not possess a cost or other value that can be measured reliably will also warrant disclosure in the notes in the financial report where information about the assets is considered to be relevant to the users of the financial report in making and evaluating decisions about the allocation of scarce resources. For example, an entity may, at the reporting date, be engaged in litigation in pursuit of a claim for damages. While it may be probable that service potential or future economic benefits will eventuate, it may be impossible to reliably measure the value of the claim. Nonetheless, disclosure of the claim, if material, could assist users in making assessments related to the present and expected future financial position of the entity.

Guideline

115. Where material, details of those assets not recognised in the statement of financial position due to the "reliable measurement" criteria not being met are to be disclosed in the notes to GTE's financial reports for performance monitoring purposes.

ASSET VALUATION METHODOLOGY

116. **Criteria for Performance Assessment**. The starting point for assessing the efficiency in GTEs and their performance is the provision of relevant, reliable, comparable and timely information to enable measurement of the costs of inputs and the value of outputs and assist in the comparison against similar enterprises or predetermined standards.

117. Whilst SAC2 does not specify that current value information is required, there is a strong and growing body of opinion that information which does not measure current values cannot provide an adequate basis for the assessment of performance in the use of resources.

118. **Historic Cost Information**. Historic cost measurement of assets is based on the original cost to the entity of acquiring the asset including the relevant financing costs during construction and installation and set up costs. There are a number of advantages of the historic cost model from a financial statements preparation and audit viewpoint. The measurement is normally based on

verifiable documentation (invoices, actual finance costs etc), the sources of which are external to the reporting entity.

119. In the pure historic cost model there would be no revaluation of assets. In practice most reporting entities have revalued some or all of their assets to current value. Obviously, as soon as a revaluation is made the entity has moved from the historic cost model. Unless all assets (and probably all liabilities) are revalued to a current value and assuming that only some revaluations have been made, the reporting entity will have a modified historical cost or partial current value model (subject to timing since last revaluation).

120. **Evaluation of Historic Cost Basis**. Measurement of assets at historic cost (less, where applicable, accumulated depreciation) reports the unconsumed portion of the original nominal dollar investment in the productive capacity of the asset. In the public sector, this information might be viewed as being consistent with the discharge of accountability for the funds entrusted to the entity - particularly where the entity receives contributions from Governments and uses them to acquire non-current assets. In addition, it has been argued that the use of historic cost is advantageous to preparers and auditors because those costs are objectively determinable since they result from transactions with external parties and avoid the costs associated with determining current values. In addition, because of their objectivity and ease of documentation, historic costs have been argued to be readily verifiable by independent auditors.

121. However, where an entity uses current market buying or selling prices to value assets, those prices also can be objectively verified by independent auditors. In addition, the use of historic costs does not alleviate the need to make subjective allocations in determining the carrying amounts of assets and the asset-related costs to be recognised as expenses in particular reporting periods. For example:

a. recognition of depreciation involves estimation of the useful lives of depreciable assets, the appropriate method for measuring the pattern of consumption or loss of the assets' service potential over their useful lives, and the amount obtainable from disposal of the assets at the end of their useful lives;

b. estimation of the recoverable amounts of an entity's assets will often be necessary. Irrespective of the asset measurement basis adopted, where the service potential of assets is dependent on their ability to generate net cash inflows, the assets should not be measured at amounts exceeding the net cash inflows expected from them; and

c. where assets are constructed or developed by the entity, costs need to be allocated between those attributable to the acquisition of the service

potential embodied in the assets and those which relate to the general operations of the entity and are therefore charged to expense.

122. Moreover, the generally accepted notions of accountability of management and governing bodies in the public sector have broadened in recent years to encompass accountability for the entity's performance in achieving its objectives. SAC2 defines "performance" as "the proficiency of a reporting entity in acquiring resources economically and using those resources efficiently and effectively in achieving specified objectives". Therefore, from an accountability perspective, general purpose financial reports should disclose information which will be useful to users in assessing, *inter alia,* the cost of goods and services provided by the entity during the reporting period and the extent to which the capacity of the entity to continue to provide needed goods and services has been maintained. The phenomena of changing prices and changing technology cause historic costs to become poor indicators of the remaining service potential of assets, and consumption thereof for the current reporting period. As such, historical costs are not particularly relevant to the disclosure of information about these key aspects of performance, whether for resource allocation decisions or the discharge of accountability. This is particularly so for GTEs, as a significant proportion of their assets have very long useful lives.

123. A major problem with a pure historic cost model is the impact of changing prices on the value of assets (and liabilities) of the entity and the difficulty in assessing performance including comparisons with other entities. The addition of historic costs of assets acquired during different reporting periods involves the addition of nominal amounts having different purchasing power and, therefore, differing economic significance. In addition, measurement of asset depreciation in historic dollar terms and revenues in current dollar terms results in the comparison, in the operating statement, of items having differing economic significance. These aspects of historic cost valuation impede the reporting of clear messages to users about the meaning of the amounts attributed to assets and expenses, and detracts significantly from the comparability of general purpose financial reports prepared on an historic cost basis by different GTEs. A problem of particular concern with the application of historic cost values to public sector assets is that any assets donated to the entity or otherwise acquired without cost would not normally be recognised in the statement of financial position.

124. **Current Value Information**. As indicated in this paper, where there is a market for the capital or equity of the entity, a form of current value of the overall asset/liability position is available. For those entities not subject to a market value test a form of accounting is required to achieve a surrogate of the market value test.

125. Most expenses and revenue are normally expressed in current dollar values and only current value information relating to assets permits reliable calculation of return on assets and other performance indicators.

126. As a result only current value information can provide information that will comply with these attributes and provide the "best" information as the basis for the use of national performance indicators for GTEs.

127. Management also requires relevant and reliable information on which to base its decisions on financing, budgeting, setting of output targets, investment in productive capacity, calculation of costs including for responsibility management/accounting, pricing etc and it is considered that current value information more adequately fills this need.

128. **Unique Public Sector Issues**. An important distinction between private sector reporting entities and those in the public sector is the general absence of a competitive market in the capital or equity of public sector entities. As a result, there is no market value test to determine a current value of the whole entity.

129. Current cost accounting in the 1970s and early 1980s (which includes the development of SAP1), was not successful in terms of application. The reasons suggested have been that, in the private sector, the stock market provides a current value test with regard to the equity of those bodies listed and, at least in Australia, the taxation system is primarily based on historic cost or other nominal values as compared to some form of current value.

130. In the absence of a market value test of the value of equity, there is a need for a surrogate based on current value accounting principles to be adopted for public sector commercial entities in order to assess the financial performance of those bodies.

131. Another significant unique factor is that assets held by many public sector entities are long life infrastructure assets. The relative long useful lives of these assets means that the impact of changing prices is likely to be greater on financial information.

132. **Pricing Decisions Under Monopoly Conditions**. One of the management information needs of any organisation operating under monopoly conditions is adequate, accurate and timely information on the costs of services. One approach in determining an appropriate level of prices in the absence of market forces is to consider the cost of utilisation of assets and to base the prices on that cost and on the holding costs of capital associated with the net assets on an opportunity cost basis. This implies the use of current value information.

133. **Surplus/Under Utilised Assets**. In considering the provision of information on the use of assets and the return being achieved, it is argued that

the use of historic cost information may mean that there is not sufficient motivation for management to identify surplus or under-utilised assets and to consider whether any value from alternate use (sale or use elsewhere in the organisation) would exceed the return being achieved in the current mode of operation.

134. It is argued that one mechanism for identifying surplus or under utilised assets may be by setting target rates of return based on the current value of assets where those rates of return are specifically based on the service potential in current use or in best available alternate use by the GTE.

135. **Measuring Performance/Target Setting**. To assess the performance of GTEs, some Governments use a number of financial and non-financial targets. These include rate of return on assets in use and rate of return on the current value of equity.

136. In order to provide a consistent and reliable approach in terms of target rates of return, those Governments have found it necessary to use a current value accounting approach to valuing assets in order to assess the actual rate of return being achieved on those assets.

137. **Information for Taxation Purposes**. Some GTEs are required to comply with Australian Taxation laws either directly to the Australian Taxation Office or through payment of income tax equivalents to the relevant State or Territory.

138. In order to comply with the requirements of the Taxation laws, which are primarily based on historic cost with regard to depreciation on non-current physical assets, there will be a need to maintain information on that basis for taxation purposes. The taxation legislation often adopts depreciation rates different to those related to asset usage or the life of the asset, so different data for depreciation of assets for taxation purposes than for accounting purposes will be required. This is in addition to a different depreciation figure in the accounts for those depreciable assets which have been revalued as against the depreciation based on historic cost for taxation purposes.

139. **Measurement/Comparability with the Private Sector**. It is expected that a number of GTEs will adopt a current value approach to asset measurement in their general purpose financial reports. It will not however be possible to directly compare their results with private sector entities which, in the absence of standards requiring a consistent valuation methodology for assets, generally adopt a partial and selective revaluation of assets approach.

140. Given the current inconsistent approach to valuation of assets care needs to be taken in attempting to compare the performance results of GTEs including

rate of return on assets with bodies reporting in line with private sector reporting practices.

141. In practice, comparability of the performance of private sector entities tends to be on a market value yield basis which, as mentioned elsewhere in these Guidelines, is not possible for GTEs.

142. **Adoption of Current Value Information**. The position adopted in this Explanatory Paper is that, when compared with the information reported incorporating assets measured at current values, the information reported incorporating assets measured at historic cost would be less useful to users for making decisions about the allocation of scarce resources and for the discharge of accountability by managements. Therefore, the Sub-committee adopted the view that assets should be measured on a current value basis if financial reports of GTEs are to satisfy the qualitative characteristics of financial information set out in SAC3 and achieve the objectives of general purpose financial reporting set out in SAC2. It should be noted that the reasons for this view have equal force for general purpose financial reports of GTEs whether or not those reports were to be used for rate of return assessments – for example, where the GTE is a not-for-profit entity or has operations which are carried on for the purpose of satisfying “community service obligations".

Guideline

143. "Current Value” methodology is be used as the basis for valuation of GTE assets for performance monitoring purposes.

RELIABILITY AND AUDIT

144. Audit has a role in adding value to information by forming and reporting an opinion on whether management’s assertions conform with the position they claim to represent. With the wide range of circumstances to be addressed by GTEs in obtaining market values and replacement costs, the audit process will play a significant role in addressing whether the valuations are free from bias and undue error. For these reasons, it is considered that information collected and reported for “performance monitoring” purposes should be subject to audit.

145. It is anticipated that it may take some GTEs a period of time to put into place arrangements, either external or internal, to obtain appropriate valuations and access to appropriate special purpose price indices. Similarly it can be expected that auditors may require some time to establish their procedures and to assess the processes and procedures put into place by GTEs, before they are satisfied that valuations are free from bias and undue error.

146. Particularly during the initial implementation period, considerable caution will need to be exercised to ensure that inappropriate weight is not given to unaudited financial data submitted for performance monitoring purposes.

Guideline

147. To give added value and credibility to the performance indicators, the financial information used as the basis for the indicators is to be subject to external audit.

CURRENT GOVERNMENT GUIDELINES/POLICY ON ASSET VALUATION

148. Current Government guidelines and policies on asset valuation range from historic cost, through historic cost with some revaluation at market value to current cost and do not provide a consistent base for the comparison of performance indicators. If the task of useful performance monitoring is to be successful, each jurisdiction may require varying degrees of change to its policies and practices to ensure that a consistent set of guidelines is applied. This will require the commitment of the participating Governments at the highest level to ensure that these Guidelines are adopted on a national basis.

149. **Autonomy of GTEs**. The 1980s marked the beginning of an era of change in public sector attitudes to management and accounting with a number of governments forming the view that the provision of appropriate incentives to managers, including greater flexibility in the management of the resources for which they have responsibility, will encourage improved performance.

150. Recognising that there is an unavoidable degree of conflict between an individual entity's desire for financial flexibility, the requirements of accountability to the Parliament and overall budgetary objectives, the governments sought a different management approach and better systems of control and oversight which allow managers to make best use of available resources.

151. The approach generally taken was to provide devolution of authority from central agencies and relaxation of central control, but on the understanding that the greater freedom given to individual managers was to be balanced by a greater responsibility for results. These moves provided a catalyst for reconsidering accounting methods to find ways of measuring performance and enabling management to account for the resources under their control.

152. Progress resulted in the following arrangements:

a. Commonwealth of Australia.

(i) Public authorities are required either by their enabling legislation or the *Audit Act* to prepare financial statements in a form approved by the Minister for Finance. The Minister issues guidelines which prescribe the form and content of financial statements. These guidelines recommend methods of valuation but these methods are not mandatory.

(ii) Companies are subject only to the Corporations Law including approved accounting standards.

Rate of return targets in corporate plans could incorporate directions relating to accounting policies.

New legislation approved by the Government will require public authorities and government companies to comply with Government policies.

b. New South Wales. GTEs are required by the *Public Finance and Audit Act* to prepare annual financial statements on an accrual accounting basis and in conformity with accounting standards and the disclosure requirements as set out in the Regulations. The Treasurer is empowered to issue directions on specific accounting policies under the Act (section 9(2)(n)) and to grant exemptions from and modifications to the financial reporting requirements of the Act.

c. Victoria.

(i) The *Annual Reporting Act 1983* covers annual reporting and audit. It allows the Minister for Finance to prescribe which information is required and to direct an entity to provide financial statements other than at year end.

(ii) Powers of Government to prescribe accounting policies for GTEs are:

- *Annual Reporting Act 1983*;
- Annual Reporting (Business Undertakings) Regulations 1988 (State Electricity Commission of Victoria, Gas and Fuel Corporation of Victoria, Port of Melbourne Authority, Melbourne Water Corporation); and
- Annual Reporting (Contributed Income Sector) Regulations 1988 (Public Transport Corporation).

d. Queensland.

(i) Under the *Financial Administration and Audit Act* the Treasurer is required to issue standards with respect to:

- policies and principles for financial management and internal audit;
- content of financial statements and annual reports; and
- matters to be included in financial management practice manuals.

(ii) Once GTEs are corporatised, new arrangements will be made by legislation or agreements with Board members.

e. South Australia. The *Public Finance and Audit Act, 1987* provides a framework for financial reporting by public authorities with S41 of the Act permitting the Treasurer to issue instructions which set out the form and content of financial statements and the procedures to be followed by public authorities.

Failure to comply with the instructions is an offence under the Act.

f. Western Australia.

(i) Statutory authorities are subject to the *Financial Administration and Audit Act* and Treasurer's Instructions. The Act specifically requires accrual based financial statements.

(ii) The Treasurer's Instructions require compliance with Australian Accounting Concepts and Standards (or modified versions).

(iii) The *Financial Administration and Audit Act* empowers the Treasurer to issue instructions with respect to financial administration including the principles, practices and procedures to be observed in the establishment and keeping of accounts. Central authorities such as the Department of Transport have also issued guidelines for Return on Assets Reporting.

g. Tasmania. GTEs in Tasmania are subject to the *State Authorities Financial Management Act 1990* which permits the Treasurer to prescribe accounting policies for GTEs.

(i) S4 provides that the Treasurer may issue instructions which relate to the accounting and management of finances of a GTE including the principles, standards, practices and procedures.

(ii) S5 requires GTEs to comply with Treasurer's Instructions.

h. Northern Territory. Prescribed statutory corporations are required by their enabling legislation or the *Financial Administration and Audit Act* to prepare financial statements in a form approved by the Treasurer. The *Financial Administration and Audit Act* also requires prescribed statutory corporations to use accounting principles generally applied in commercial practice or such other manner as prescribed by the Treasurer.

i. Australian Capital Territory.

(i) The *Audit Act 1989* requires GTEs (authorities nominated by their enabling legislation as commercial) to keep proper accounts and records in accordance with the accounting principles generally applied in commercial practice, and in general terms to maintain adequate control over transactions and assets and liabilities. The Act also requires these authorities to report in accordance with Guidelines approved by the Minister. These guidelines determine the form and content of financial statements.

(ii) The *Territory Owned Corporations Act 1991* provides that Territory owned corporations are subject to the accounting and reporting provisions of the Corporations Law.

153. Thus it can be seen that some governments will need to introduce legislation or regulations for these Guidelines to be made mandatory for all GTEs. It is reiterated that, if consistent guidelines are not applied to all GTEs, the performance indicators may not be comparable and the intended performance monitoring will fail.

CURRENT PRACTICES AND PLANS OF GTES IN RELATION TO ACCOUNTING AND REPORTING OF ASSETS

154. Within the framework of policies and where the value of assets are measured, GTEs have adopted specific valuation methodologies which are as varied as the policies of the jurisdictions. For example, in a number of cases, assets within the same GTE are not valued on a consistent basis i.e. different classes of assets may be valued using historical cost and current value (or a revalued base). As with the policies, many GTEs will be required to change their valuation methodology if performance indicators using asset values are to be meaningful. It also must be noted that changing asset valuation methodologies will result in some costs, both initial and recurring, to the GTEs and any benefits gained from the application of consistent, relevant methodology must outweigh those costs in order for the changes to be worthwhile.

155. Reiterating what has been indicated in paragraph 153, consistent application of these Guidelines is required for the performance monitoring to be effective.

COMPLIANCE WITH STATEMENTS OF ACCOUNTING CONCEPTS AND AUSTRALIAN ACCOUNTING STANDARDS

156. It is acknowledged that the law of each jurisdiction will take precedence over any conflicting requirements for treatment of financial information relating to assets. However, it is recognised that to maintain a standardised accounting treatment of asset (financial) data, all GTEs should be required to comply with the relevant Australian Accounting Standards and the aspects of Statements of Accounting Concepts (where specified in these guidelines) and the development of these Guidelines has taken this into account.

Guideline

157. Within the relevant jurisdiction's legal requirements, GTEs are to either comply with Australian Accounting Standards or Corporations Law and Accounting Standards issued by the Australian Accounting Standard Board and those elements of Statements of Accounting Concepts adopted by these Guidelines.

LAYERS OF REPORTING

158. Layers Formed by Different Levels of Aggregation. Other layers of reporting can be viewed from different levels of aggregation of information originating from individual entities. Examples of these are:

a. Financial reports prepared by individual entities would constitute a primary layer of reporting whereas consolidated financial reports prepared by economic entities (parent entities and their subsidiaries) would constitute another layer.

b. Consolidated financial statements of public sector economic entities are sometimes consolidated with those of other economic entities of the same class to show the aggregates for whole 'sectors', providing further layers of reporting. These sectors are known as the 'general government sector', 'government trading enterprises sector', 'budget sector' and 'non-budget sector'.

c Whole-of-government reporting forms another layer and this may be in the form of cash based Government Finance Statistics or accrual based financial statements based on the United Nations System of National Accounts.

d. The ultimate consolidation is the National Accounts, prepared by the Australian Bureau of Statistics. This incorporates both public and private sector bodies for the nation as a whole.

159. The layers formed by different levels of aggregation could be summarised as:

a. single entities (e.g. individual departments or GTEs);

b. economic entities (e.g. a parent entity and its subsidiaries combined);

c. single sectors within the public sector (e.g. the general government sector);

d. the public sector as a whole;

e. sectors within the National Accounts (e.g. the public sector and the private sector); and

f. the consolidated National Accounts.

160. **Consolidated Financial Reporting**. Generally, the main layers of reporting for performance monitoring will be the single entity and economic entities where relevant and the latter may require the preparation of consolidated financial statements in accordance with Australian Accounting Standard AAS24, "Consolidated Financial Reports".

Guideline

161. *Where applicable, GTEs are to prepare consolidated financial reports in accordance with Australian Accounting Standard AAS24, "Consolidated Financial Reports".*

162. **Segment Reporting**. In the case of performance monitoring of GTEs, it is necessary that the reported information be disaggregated by the relevant functions to enable each specific function to be measured, and Australian Accounting Standard AAS16, "Financial Reporting by Segments", should apply.

Guideline

163. Where applicable, reported information is to be disaggregated by the relevant functions and Australian Accounting Standard AAS16, "Financial Reporting by Segments", is to apply.

MEASUREMENT OF ASSET VALUES

164. **Valuation of Assets, Not the Business**. Because of explicit and implicit limitations on their operations, the measurement of the values of individual assets of the GTE, rather than the value of the GTE as a business, is considered to be more relevant in the context of GTE performance monitoring.

165. **Going Concern Basis**. In the event that application of the going concern basis is not appropriate to the circumstances of the GTE or a material segment thereof, the assets so affected should be measured at the amounts expected to be

obtained for them through liquidation of the GTE or segment thereof. These net selling values should be measured having regard to prices obtainable through orderly sale or to distress sale prices, according to the circumstances. If application of the going concern basis is appropriate, the basis of valuation should be the economic value of the assets to the GTE in its operations.

166. **Economic Value of Assets**. At this stage it is illustrative to consider an economist's approach to valuation. It has been said that "The economic value of an asset is that which would emerge if the asset were traded in a fully competitive market. This will be the value that, taking into account the expected stream of future cash flows and disposal value of the asset, will generate a rate of return to the buyer equal to that earned if the resources were used elsewhere in the economy." (Industries Assistance Commission[1], 1989, p. 148)

167. In other words, under perfectly competitive market conditions, the discounted future cash flow stream should equate with market value. In this context, "market value" means the price that would be negotiated in an open and unrestricted market free of transaction costs between informed, willing but not anxious buyers and informed, willing but not anxious sellers, each of whom are price-takers acting at arms length. Therefore, in a perfectly competitive market, the value or market value of a GTE's asset would be its market buying price, the market selling price or net present value of future cash flows relating to the asset and these would all be the same.

168. The existence of imperfections in most product markets has given rise to considerable debate amongst economists and accountants as to which contemporary asset valuation concept is most useful for satisfying the objective of general purpose financial reporting. Government trading enterprises frequently operate in markets which range from monopolistic to oligopolistic. As such, the implications of relaxing the theoretical assumption of perfectly competitive markets are a significant issue to the identification of the preferred measurement basis for assets controlled by GTEs. This is particularly the case with physical non-current assets of GTEs which would generally be those assets of GTEs which are traded in the least perfect markets.

169. **Measurement Basis Adopted - Current Value to the Entity**. "Current value to the entity" is the appropriate measurement concept for physical non-current assets of GTEs. This concept recognises that, because of the imperfections of the markets in which physical non-current assets of GTEs are exchanged, the value of the service potential will frequently differ from their

[1] Industries Assistance Commission (1989), *Government (Non-tax) Charges,* Vol. 3, AGPS, Canberra.

current net market selling price or exchange value. The current net market selling price or exchange value of an asset will not differ according to the entity which controls the asset and, for particular GTEs, may not reflect the service potential of physical non-current assets used by the GTE to pursue its objectives. Accordingly these Guidelines adopt the concept of "deprival value" as the basis for application of the "current value to the entity" concept.

170. Under the deprival value approach, assets are valued at an amount that represents the entire loss, both direct and indirect, that it might be expected to be incurred by an entity if that entity were deprived of the service potential or future economic benefits of the assets at the reporting date. Thus the value to the entity in most cases will be measured by the replacement cost of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the replacement cost represents the amount of cash necessary to obtain an equivalent or identical asset.

171. Under the deprival value concept, the primary basis for valuation when the service potential or future economic benefits of an asset would be replaced if the GTE was deprived of the asset is:

a. current market (buying) price of a similar asset where a similar asset can be purchased;

b. current replacement cost of the same service potential or future economic benefits of the existing asset where a different asset having a similar purpose can be purchased; or

c. the current reproduction cost of the same service potential or future economic benefits of the existing asset where the above techniques are not applicable.

172. There may be certain circumstances when assets are currently being used in operations and the service potential or future economic benefits of an asset would not be replaced if the GTE was deprived of the asset. This may arise where the delivery of goods and services will not be continued once the existing life of the existing asset has ceased or the delivery of the goods and services has a finite end date in the next reporting period. In these circumstances it is relevant to base the value of these assets on the expected future cash flows embodied in the asset, that is, the expected cash flows from continued use and subsequent disposal of the asset. This value would be adopted only if it exceeds the current market value (selling price) based on its feasible alternative use, taking account of the costs of achieving that potential.

173. There may also be assets which are surplus to the operations of a GTE as at the reporting date. It is also appropriate to value these assets on the expected

future cash flows embodied in the asset and the deprival value is measured in terms of the loss of the exchange value of the asset.

174. **Measurement Methodology**. In practice, application of the concept of deprival value means that physical non-current assets will be measured as follows:

a. Assets Held for Continued Use.

   (i) Where the remaining service potential embodied in an asset held for further use would be replaced if the GTE was deprived of the asset, the asset should be measured at its current cost; and

   (ii) Where the remaining service potential embodied in an asset held for further use would *not* be replaced if the GTE was deprived of the asset, the asset should be measured at the greater of the net present value of the cash flows expected from continued use and subsequent disposal of the asset or the current market value (selling price) .

b. Surplus Assets. Surplus assets (that is, assets held for sale without replacement) should be measured at their current net market selling value.

Guidelines

175. Deprival value is to be used as the method of application of current value methodology for assets of GTEs participating in the performance monitoring exercise. Under this approach, assets are valued at an amount that represents the loss that might be expected to be incurred by an entity if that entity were deprived of the service potential or future economic benefits of these assets at the reporting date. Thus the value to the entity in most cases will be measured by the replacement cost of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the replacement cost represents the amount of cash necessary to obtain an equivalent or identical asset.

176. Under this methodology

a. *where the service potential or future economic benefits embodied in the asset would be replaced if the GTE was deprived of the asset, the primary bases for valuation of assets are:*

   (i) current market (buying) price of a similar asset - where a similar asset can be purchased;

   (ii) current replacement cost of the same service potential or future economic benefits of the existing asset - where a different asset having a similar purpose can be purchased; or

(iii) current reproduction cost of the same service potential or future economic benefits of the existing asset where the above techniques are not applicable.

b. where the service potential or future economic benefits embodied in the asset would not be replaced if the GTE was deprived of the asset, the basis for valuation of assets is the net present value of the cash flows expected from continued use and subsequent disposal of the asset.

c. surplus assets (that is, assets held for sale without replacement) are to be measured at their current net market selling value.

177. **Guidance in Statement of Accounting Practice SAP1**. SAP1 (first issued in 1976) is founded on deprival value concepts. These Guidelines adopt the methodology of SAP1 only in relation to the measurement of assets. They do not require application of any aspects of current value reporting other than measuring the service potential embodied in physical non-current assets and the consumption of that service potential in the provision of goods and services during the reporting period. As such, the application of SAP1 to the measurement of physical non-current assets should not be read as a requirement to adopt a "current cost accounting" financial reporting model.

178. **Land**. The view of the Sub-committee is that land should be measured consistently with the measurement policies to be applied to other physical non-current assets of GTEs – that is, at deprival value.

179. Where land is held for continued use and would be replaced if the GTE was deprived of it, the value of that land under the deprival value framework would be the current market buying price of that land in its current use. As land is potentially the most universal of physical non-current assets and since its purpose may be readily changed from one function to another (given time and resources) these Guidelines require that the higher value of current market buying price and the current market value (selling price) based on its feasible alternative use, taking account of the costs of achieving that potential.

180. In applying the deprival value framework, the value to be adopted is not the cost of acquiring the adjacent land and, where necessary, removing the improvements to obtain an identically shaped site. This method may result in substantially overstating both the value of the land in its current use and the net proceeds which could be obtained from its feasible alternative use taking into account the costs of achieving that alternative use. The current entry price (given by the cost of acquiring adjacent land) is not relevant to the performance monitoring decisions to be made in respect of GTEs. Rather the decisions for performance monitoring purposes are whether the GTE is earning an adequate return based on the value of the land in its current usage and whether a higher

return could be obtained by releasing this land for another feasible alternative use.

181. Where the land would not be replaced if the GTE were deprived of it, the replacement cost concept (i.e. current market buying price) is inapplicable. In this case, as for other assets held for continued use that would not be replaced if the GTE was deprived of them, the primary basis of valuation is the net present value of the cash flows expected from the continued use and subsequent disposal of the asset. As above, this value should be tested against the current market value (selling price) based on its feasible alternative use, taking account of the costs of achieving that potential with the higher value being adopted.

182. For land which is surplus to requirements, the replacement cost concept is similarly inappropriate. The only relevant value is the current net selling price based on its feasible alternative use.

183. For accounting purposes, the value of the land is to be reported separately from that of any improvements. Also, other parts of these Guidelines may require a different measure of deprival value in the case of improvements (e.g. written down current replacement cost) to that of the land.

184. For most land, including land under infrastructure, there are well established valuation practices, which will take into account any general zoning or other restrictions on its use. Specific features of the land, such as its shape and size can be allowed for. In establishing the value in use (current market buying price) account is to be taken of the nature of the parcel, the legal restrictions on use, the opportunities and impediments to development that are inherent to the specific parcel of land, other constraints that exist in respect of that land and any special attributes that the land may possess.

185. In addressing feasible potential alternative use, general zoning restrictions should be distinguished from restrictions placed on land by Government which are in the nature of usage restrictions. Examples are land currently used for power station or water/sewerage treatment plant purposes. It is not to be assumed that the only use to which this land could be put in the future would be for these specific purposes. Where there is special zoning it simply reflects the mechanism by which the government, as owner of the GTE, recognises the current usage. Existing usage restrictions, even if reflected in special zoning or legislation, should not provide the basis on which the feasible alternative use valuation is determined. The types of zonings which would usually be relevant are the general types of zoning (residential, commercial, industrial, agricultural). The feasible alternative use should be a use which could be achieved in the relatively near future (say in the next five years) rather than some usage which could be achieved in the distant future. The costs of achieving the feasible alternative use include holding costs and the costs required for any rezoning of

the land, the restoration and/or removal of existing infrastructure and/or reparation work to restore the land to a useable condition for that use. These costs are to be assessed in establishing the current market value (selling price) of the land's feasible alternative use.

Guidelines

186. Land is to be measured consistently with the measurement policies to be applied to other physical assets of GTEs - that is, at deprival value.

187. Land held for continued use is to be valued at the greater of:

a. *current market buying price, taking into account the nature of the parcel, the legal restrictions on use, the opportunities for and impediments to development that are inherent to the specific parcel of land, other constraints that exist in respect of that land and any special attributes that the land may possess (value in use); and*

b. current market value (selling price) based on its feasible alternative use taking account of the costs of achieving that alternative use.

188. Where the service potential of the land would not be acquired if the GTE was to be deprived of it, it should be valued at the net present value of the cash flows expected from continued use and subsequent disposal of the land.

189. Where land is surplus to requirements it should be valued at the current net selling price based on its feasible alternative use.

190. **Land Under Infrastructure Assets Held for Continued Use**. It has been argued within the broader community that differing considerations should possibly apply to land under infrastructure, since while it is used for that purpose it cannot be used for another purpose. However, the same consideration applies to all land and assets - when an asset is used for one purpose it cannot be used for another. The deprival value approach expressly recognises that the value to the entity of the asset is the future benefits that the entity would forego if deprived of the asset. The view of the Sub-committee is that, as with other land, the land under infrastructure assets should be valued as a separate component of the infrastructure asset and should be measured consistently with the measurement policies to be applied to other non-current physical assets of GTEs, that is, at deprival value. In the case of some land under infrastructure, there may be no ready markets of similar land to establish values. However there are valuation techniques to address most of these circumstances.

Guideline

191. Land under infrastructure is to be valued (and reported as a separate component of the infrastructure asset) consistently with the measurement

policies to be applied to other land and other physical assets of GTEs - that is, at deprival value.

192. **Heritage Assets**. For the purposes of these Guidelines, heritage assets are those assets which a Government has decided to preserve for the duration of their physical life because of their unique historical, geographical, cultural or environmental attributes. Where assets of historical significance, such as historical buildings and works of art, are permitted to be sold or re-deployed by the GTE, or are not required to be maintained indefinitely, they are not heritage assets for the purposes of the following discussion.

193. It is recognised that some heritage assets are of a solely historical or cultural interest (for example, monuments) while others also provide a functional service.

194. The view of the Sub-committee is that heritage assets should be measured consistently with the measurement policies to be applied to other physical non-current assets of GTEs - that is, at deprival value. In addition, the Sub-committee's view is that classification of these assets between those which may be described as having purely historical or cultural interest and those which may be described as also providing functional service is not relevant to the measurement policies which should be applied.

195. Where the service potential embodied in a heritage asset would be otherwise acquired (through replacement, reproduction, rental, leasing or in any other manner) if the GTE was deprived of the asset, the deprival value of the asset will be the replacement cost or reproduction cost of the service potential embodied in the asset. Where heritage assets are viewed as having functional as well as heritage characteristics, the heritage or aesthetic utility component may be difficult to reliably measure. The key issue is whether the service potential embodied in the asset would be otherwise acquired if the GTE was deprived of the asset. The service potential is then measured consistently with the measurement policies applied to other non-current physical assets. Therefore, in measuring the deprival value of these assets, it is not necessary to identify the aesthetic utility of the asset. That is, the heritage component is in effect excluded from the asset valuation disclosed in the statement of financial position. However, additional information on the heritage component may be included in the note to the financial statements.

196. Where the service potential of the asset would not (or cannot) be otherwise acquired if the GTE was deprived of it, the asset should be valued at its recoverable amount, which normally will be its net market selling price. As above in relation to land, this value should be compared with the current market value (selling price) based on its feasible alternative use, taking account of the costs of achieving that potential with the higher value being adopted. There will

be instances where the deprival value of the heritage asset will not be recognised. This will occur where the selling price cannot be reliably measured (e.g. where there are no markets for comparable assets), or there are no cash flows associated with a heritage asset that would not be replaced if the GTE was deprived of the asset.

197. SAC3 requires information included in the financial statements to be reliable and relevant. These Guidelines therefore provide for asset values to be included in the financial statements only when they can be measured reliably. Where values cannot be measured reliably, these assets will be excluded from the financial statements. Examples are some of the following - historic library and museum collections, historical treasures and unique works of art. Information in respect of these items which is relevant for decision making purposes should, however, be disclosed in the notes to the financial statements. (This information would include, for example, the quantum and the nature and functions of the asset together with the annual costs of maintenance, where applicable).

Guidelines

198. Heritage assets are to be valued consistently with the measurement policies to be applied to other physical non-current assets of GTEs - that is, at deprival value. Classification of assets between those having purely historical or cultural interest and those which also provide a functional service is not relevant to the measurement policies to be applied.

199. Where the service potential embodied in the heritage asset would be acquired (through replacement, reproduction, rental, leasing or in any other manner) if the GTE was deprived of the asset, the deprival value of the asset is the current cost of the service potential or future economic benefits embodied in the asset. Where the service potential of the asset would not be acquired if the GTE was to be deprived of it, the asset should be valued at its recoverable amount,[i.e the greater of the net present value of future cash flows and current market selling price. Normally the appropriate value is the net market selling price if it can be determined reliably with reference to markets for comparable assets.]

200. **General Assets**. These are assets which are not included in the asset types discussed previously and consist of specialised and non-specialised assets.

201. **Specialised General Assets**. These are general assets which, because of their special design or location would normally not be expected to be purchased on a secondary market. Examples include specialised buildings, equipment which is constructed for a purpose which is specific to the entity and buildings which are constructed in remote areas which would not be traded in a normal

manner. As there is no trading market for such assets, the appropriate value of such assets is the lower of the current replacement cost and the current reproduction cost of the gross service potential of the existing asset.

202. **Non-specialised General Assets**. These are general assets which are normally traded on a secondary market. Examples include motorcars, houses and office accommodation in cities, furniture etc which would be traded in a normal manner. The appropriate value of such assets is the current market buying price of the gross service potential or future economic benefits of the existing asset. This requires that assets be valued in such a manner as they are normally acquired i.e. acquired in a secondary market or not normally acquired in a secondary market. However, most GTEs will only acquire new assets and it is inappropriate to value the assets based on second hand prices as this may result in understatement of depreciation expense and a greater risk of capital being eroded.

Guidelines

203. Where the service potential or future economic benefits embodied in the asset would be replaced if the GTE was deprived of the asset, general assets are to be valued as follows:

a. where there is a secondary market for the asset (non-specialised general assets) – current market buying price of the gross service potential of the existing asset. Where the assets are not normally acquired in a secondary market, the price of a new asset is relevant to determining the value of the asset and where the assets are normally acquired in a secondary market, the price of a second hand asset is relevant to determining the value of the asset; and

*b. where there is no secondary market for the asset (specialised general assets) - lower of the current replacement cost or current reproduction cost of the gross service potential or future economic benefit of the existing ass*et.

204. Where the service potential or future economic benefits embodied in the asset would not be replaced if the GTE was deprived of the asset, general assets are to be valued at the greater of net present value and current market value (selling price).

205. Where a general asset is surplus to requirements it should be valued at the current market value (selling price).

206. **Measurement Methodology Summary**. The bases of measurement are summarised in the following table.

Measurement Bases to be Applied Under these Guidelines to Particular Categories of Physical Non-Current Assets

Asset Category	*Where service potential would be replaced if GTE was deprived of the asset*	*Where service potential would not (or could not) be replaced if GTE was deprived of asset*
Asset Held for Continued Use		
Land (including land under infrastructure)	*The greater of*: Current market buying price, taking into account the nature of the parcel, the legal restrictions on use, the opportunities and impediments to development that are inherent to the specific parcel of land or other constraints that exist in respect of that land, or any special attributes that the land may possess (value in use); and Current market value (selling price) of its feasible potential alternative use taking into account the costs of achieving that potential	Greater of net present value and current market value (selling price)
Heritage assets	Current market buying price, current replacement cost or current reproduction cost, as applicable, of the gross service potential utilised by the GTE if the service potential would otherwise be acquired by the GTE	Greater of net present value and current market value (selling price)
General assets		
– where there is a secondary market for the asset (non-specialised assets)	Current market buying price of the gross service potential of the existing asset - where new assets are normally acquired, new prices are relevant and where second hand assets are normally acquired, second hand prices are relevant	Greater of net present value and current market value (selling price)
– where there is no secondary market for the asset (specialised assets)	Lower of the current replacement cost or current reproduction cost of the gross service potential or future economic benefit of the existing asset	Greater of net present value and current market value (selling price)
Surplus Assets		
All such assets	Not Applicable	Current market value (selling price)

207. **Depreciation**. Depreciation is the method by which the value of an asset with a limited useful life is allocated over the period in which it provides service potential or economic benefits to the controlling entity. In order to allocate that value and to more accurately reflect the remaining service potential or future economic benefits of an asset after a period of use, it is necessary that all non-current assets with limited useful lives ("depreciable assets") be depreciated by the systematic and progressive recognition of depreciation expense in the operating statement over the useful lives of those assets.

208. **Useful Life**. To ensure the measurement of depreciable assets at their deprival value, the Guidelines adopt the concept of "useful life" set out in SAP1 which is "the estimated total period, from the date of acquisition, over which the service potential of the asset is expected to be used up in the business of the entity". It should be noted that, in this regard, the residual values at the end of their useful lives to the entity would be used in determining the depreciable amount of each of those assets.

Guidelines

209. All non-current assets with limited useful lives ("depreciable assets") are to be depreciated in accordance with Australian Accounting Standard AAS4, "Depreciation of Non-Current Assets", except that the definition of "useful life" set out in Statement of Accounting Practice SAP1, "Current Cost Accounting", is to be applied.

210. For the purposes of these Guidelines, "useful life" means "the estimated total period, from the date of acquisition, over which the service potential of the asset is expected to be used up in the business of the entity" (Statement of Accounting Practice SAP1, paragraph 49).

211. **Depreciation Method**. Useful lives may be on a time or output basis or, in some special cases, revenue. There are a number of methods for the application of depreciation including straight line, reducing balance and production units method. Due to the diverse nature of assets used by GTEs, it is not considered practical to adopt a single depreciation method for all assets. It is considered necessary that GTEs adopt the method of depreciation that most closely reflects the pattern of consumption or loss of the service potential embodied in their depreciable assets.

Guideline

212. GTEs are to adopt the method of depreciation that most closely reflects the pattern of consumption or loss of the service potential embodied in their depreciable assets. Therefore, no single method of depreciation is prescribed for the depreciable assets of GTEs. The guidance contained in paragraphs 22

to 24 of Australian Accounting Standard AAS4 is appropriate to the selection of the relevant depreciation method for depreciable assets of GTEs.

213. **Revaluation of Assets**. To ensure that asset values are reported in current terms it is necessary that periodic revaluation of assets be performed.

214. **Full Revaluations**. It is realised that to perform "full" revaluations of all assets is costly and resource consuming but this must be balanced against the possibility of recorded values diverging significantly from the current value. To ensure that any variation is corrected within a reasonable time, "full" revaluations should be conducted at least every five years subject to materiality and the relevant revaluation threshold. It is recognised that "full" revaluations may be resource intensive and GTEs should consider conducting them on a rolling basis to even out the work load and demand for resources.

215. **Interim Revaluations**. Even with moderate price and technological changes, it has been recognised that the values of assets may change considerably resulting in diminution of the value of the reported information if no adjustment is made to asset values. As a result, it is considered that it would be appropriate to index the asset values in each of the years between the full valuations as a cost effective method of maintaining current value information. Over the years it has been shown that the application of the Consumer Price Index (CPI), which is the movement in prices of a "basket of consumer goods", to asset values quite often results in considerable divergence from the current value. This is especially true in areas of rapidly changing technology, imported goods and assets for which there is no ready market. Thus, it is considered that the practice of applying the CPI to asset values may not be relevant.

216. As a result, the application of relevant industry or technological index to asset values in the intervening period on a yearly basis is the preferred method of adjustment of current values for annual reporting purposes. This procedure is also subject to the relevant materiality standard and the relevant revaluation thresholds being observed.

Guideline

217. Full revaluations of assets are to be performed at least on a five yearly basis with values being updated in the intervening years by the application of the relevant industry or technological index on an annual basis. The full revaluations may be performed on a rolling basis to even out the work load and demand for resources.

218. **Asset Capitalisation and Revaluation Thresholds**. In addition to a limited number of major assets, most GTEs control a large amount of relatively low value items which, if they were to be managed and reported in detail, would result in excessive costs for very limited benefits. These items would normally

include chairs, desks, filing cabinets, curtains and other fittings, low value tools, test kits etc. To minimise costs and to provide more relevant information, while also maintaining accountability, separate asset capitalisation and revaluation thresholds have been identified are to be determined by each GTE as follows:

a. Capitalisation (based on $ value). This is the value above which items are to be recorded as assets. Application of a suitable capitalisation threshold and related control and reporting practices should result in more cost effective management of assets; and

b. Revaluation (based on $ value and useful life). This is the value or useful life above which assets are to be revalued (including interim revaluation). Application of a suitable revaluation threshold will minimise the cost of revaluation while still providing relevant information.

219. The relevant value in the case of each GTE for the application of the thresholds is the fair value of the asset at the time of acquisition of control in accordance with AAS21. If control was acquired before the GTE applied these Guidelines and the fair value at the time of acquisition of control is not known, the GTE can utilise the deprival value adopted on the application of the Guidelines for the purpose of applying the thresholds.

220. It was not considered beneficial to specify standard Australia-wide thresholds on a central basis because of differing materiality levels between GTEs, which depend on the size of the GTE and the varying values of each GTE's assets. To overcome the difficulties from these considerable variations, it was considered preferable that each GTE should set its own thresholds within the policies of the relevant jurisdiction.

Guidelines

221. Each GTE is to set:

a. *a Capitalisation Threshold, being the value above which items are capitalised as assets; and*

b. a Revaluation Threshold being the value and/or useful life above which assets are to be revalued in accordance with these Guidelines.

222. GTEs are to set their own thresholds within the policies of the relevant jurisdictions. The relevant value for the application of the thresholds is the fair value of the asset at the time of acquisition of control. If this is not known for assets acquired before these Guidelines applied, the GTE can utilise the deprival value adopted on the application of these Guidelines.

223. **Grouping of Similar Assets**. Some GTEs control large numbers of similar assets with individual values below the capitalisation threshold but which, when grouped together, represent a total value which is a significant

percentage of the total value of the GTEs assets. These may include chairs, desks, personal computers etc. Given the possible materiality of these groups of assets, GTEs may wish to group the similar assets and capitalise that group.

Guideline

224. Where a GTE controls a large number of similar assets with individual values below the capitalisation threshold but which, when grouped together, represent a value which is a significant percentage of the total asset value, the GTE, having regard to materiality, should consider grouping those assets for the purpose of capitalisation.

RECORDING AND REPORTING OF ASSET VALUES

225. **Recording of Asset Values**. It has been suggested that assets need only be recorded at "written-down" values (or the value of a similar asset taking into account the age and condition of the existing asset) as this reflects the service potential or future economic benefits remaining after the application of accumulated depreciation. This practice is considered deficient as it will mask the value of the gross service potential involved for maintenance management, planning and replacement purposes and other resource management decisions. Accordingly it is considered that the gross service potential or future economic benefits and the accumulated depreciation should be recorded in the GTE's records to give the written down value (also see paragraph 230).

Guideline

226. The current value of the gross service potential or future economic benefits of assets is to be recorded in the GTE's records.

227. **The Recoverable Amount Test**. Paragraph 29 of Australian Accounting Standard AAS10, "Accounting for the Revaluation of Non-Current Assets" (re-issued on April 1993), states that "Subject to paragraph 30, a downwards revaluation of a non-current asset shall be undertaken when, and only when, its carrying amount is greater than its recoverable amount. In this situation the asset shall be revalued to its recoverable amount."

228. The "recoverable amount" of an asset is defined in AAS10 as "the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal" (paragraph 13).

229. In determining the recoverable amount of a non-current asset for the purposes of applying the concept of deprival value, it will be necessary to use the net present value of future cash flows expected to be derived from use and ultimate disposal of the asset (SAP1, paragraph 29).

230. **Applicability of the Recoverable Amount Test.** These Guidelines adopt the view that the recoverable amount test should be applicable to a physical non-current asset of a GTE when, and only when, the service potential of the asset is dependent on its ability to generate net cash inflows from the goods and services provided. As such, the recoverable amount test would not be applicable to those physical non-current assets of a GTE deployed to provide services which the government requires the GTE to continue to provide irrespective of whether the government requires the full cost of services to be recovered.

231. These Guidelines do not require that non-current assets which are deployed to satisfy community service obligations be written down to recoverable amount. Under these Guidelines the recoverable amount test is not applicable to this category of GTE assets. This is consistent with AAS10.

Guideline

232. *The recoverable amount test is only to be applied where the GTE is a profit seeking organisation and to a physical non-current asset of such a GTE when, and only when, the service potential of the asset is dependent on its ability to generate net cash inflows from the goods and services provided.*

233. **Disclosure of the Initial Application of the Recoverable Amount Test**. Where, on initial application of these Guidelines, physical non-current assets are revalued to the recoverable amount, the financial report should disclose separately the revaluation of the asset to its written-down current cost (credited/debited to asset revaluation reserve) and the write-down of the asset from written-down current cost to recoverable amount (shown as an adjustment directly against retained profits/surplus or accumulated losses/deficiency). This disclosure will identify restatements attributable to current input costs and restatements attributable to losses of service potential.

Guideline

234. Where the recoverable amount test is applied, the effects of the initial application of the test are to be disclosed in the notes to the statement of financial position.

235. **Reporting of Asset Values**. To accurately reflect the value of an asset to the entity, it is necessary that only the remaining service potential or future economic benefits of assets be reported. In the case of assets with infinite useful lives such as land this equates to the value of the gross service potential or future economic benefits of the asset. However, in the case of an asset with a limited useful life it is necessary that only the residual value to the entity after a period of use be reported. This is done by subtracting accumulated depreciation (which is the total of depreciation expense for an asset from the date of

acquisition to the reporting date) from the value of the gross service potential or future economic benefits recorded in the records to obtain the written-down value of an asset.

236. As discussed above, the Recoverable Amount Test may be applicable to some assets. When this occurs, the assets are to be reported at the lesser of the above and the recoverable amount.

Guidelines

237. Where the recoverable amount test does not apply, for assets with infinite useful lives, the gross value of the service potential or the future economic benefits embodied in the asset is to be reported in the GTE's statement of financial position. For assets with a limited useful life, the written down value of the asset is to be reported in the GTE's statement of financial position.

238. Where the recoverable amount test applies, for assets with infinite useful lives, the lesser of the gross value of the service potential or the future economic benefits embodied in the asset and the recoverable amount is to be reported in the GTE's statement of financial position. For assets with a limited useful life, the lesser of the written down value of the asset and the recoverable amount is to be reported in the GTE's statement of financial position.

ENGAGEMENT OF VALUERS

239. Valuers employ various methodologies for the valuation of assets. The specific methodology depends on the purpose of the valuation. This purpose is normally conveyed to a valuer by the use of an engagement letter. For performance monitoring to be useful, a consistent valuation methodology is required and, to achieve this, GTEs should use consistent terms of engagement. For accounting purposes, the value of the land is to be reported separately from that of any improvements. The values (e.g. market buying or selling prices) to be recognised in the financial statements should take into account the relevant transaction costs. Adjustments may need to be made to the valuations provided by valuers in order to take these transaction costs into account.

240. In conjunction with the Valuers-General in Australia and the Institute of Valuers and Land Economists, the Sub-committee has developed a model Letter of Instruction which, when used, should assist valuers in providing consistent valuation of assets across GTEs.

Guideline

241. To achieve consistency in valuation, jurisdictions should ensure that any instructions to valuers embody the principles set out in the model Letter of Instruction contained in Appendix B.

VALUATION ISSUES

242. Having decided on the valuation methodology and its practical application, the following related issues have been identified.

243. **Identification of Relevant Costs on Acquisition of Assets**. In determining which costs should be included in the determination of the current cost of a physical non-current asset of a GTE, the following guidance is provided.

244. Australian Accounting Standard AAS21, "Accounting for the Acquisition of Assets (including Business Entities)", identifies the cost of acquisition of an asset as the purchase consideration plus any costs incidental to the acquisition of the asset.

Guideline

245. The provisions of Australian Accounting Standard AAS21, "Accounting for the Acquisition of Assets (including Business Entities)", are to be applied when determining the value of an asset when acquired.

246. **Contributions by External Parties**. In a number of cases, GTEs have received contributions towards assets from external parties either by way of direct contribution of an asset or an up front payment to allow the GTE to either purchase or construct the asset.

247. The nature of financing the assets (e.g. company contribution) or the fact that the asset was received by way of transfer from an external party (normally a user of the asset) in no way impacts on the value of the asset itself. The asset should be recognised as an asset of the GTE if it meets the criteria adopted by these Guidelines and brought to account at its fair value at the date of acquisition of control.

248. The question as to the appropriate pricing regime adopted by a GTE with respect to such assets is beyond the scope of these Guidelines and is a matter for individual GTEs and their respective Governments. In some cases, the GTE may wish to provide compensation to the user of an asset through lower prices than would otherwise be commercially appropriate to reflect the fact that the user has contributed in part or in full towards the purchase or construction of an asset. However, it is clear that the fact that an asset is funded by an external

party in no way affects the methodology adopted with respect to recognition and valuation of that asset.

Guidelines

249. Where a GTE has received contributions towards assets from external parties either by way of direct contribution of an asset or some up front payment to allow the GTE to either purchase or construct the asset, the asset is to be recognised as an asset of the GTE if it meets the criteria adopted by these Guidelines and brought to account at its fair value at the date of acquisition of control.

250. The question as to the appropriate pricing regime adopted by a GTE with respect to such assets is beyond the scope of these Guidelines and is a matter for individual GTEs and their respective Governments. In some cases, the GTE may wish to provide compensation to the user of an asset through lower prices than would otherwise be commercially appropriate to reflect the fact that the user has contributed in part or in full towards the purchase or construction of an asset. However, it is clear that the fact that an asset is funded by an external party in no way affects the methodology adopted with respect to recognition and valuation of that asset.

251. **Finance Costs**. The Sub-committee considers that, for completeness of measurement, interest and other financing costs incurred in the process of acquiring the service potential embodied in an asset should be included in the determination of the current value of the asset where those costs can reliably be attributed to the asset.

252. The "capitalisation period" during which finance costs should be included in the current value of the asset is the period during which all of the following tests are met:

a. expenditures on the asset are being made or borrowings have been made for the purpose of such expenditures;

b. activities necessary to prepare the asset for use by the GTE are underway; and

c. financing costs are being incurred.

253. Where assets comprise a group of components, some of which can be used prior to the completion of the total asset structure, financing costs should cease to be capitalised in respect of particular components when they are ready for use.

254. Where borrowings are made in respect of assets under development, and are invested prior to remission of the funds to suppliers or contractors (for example, where delays occur), any interest revenues generated as a result should

be deducted from the interest costs included in the determination of the asset's cost.

Guideline

255. Interest and other finance costs incurred in the process of acquiring the service potential or future economic benefits embodied in an asset are to be included in the value of an asset when those costs can be reliably attributed to the existing asset.

256. Assets Constructed by the GTE for Use in its Operations. For the purpose of identifying the costs that are incidental to the acquisition of an asset constructed by the GTE for use in its operations, consistent with the requirements of AAS21, this paper adopts the view that the guidance set out in paragraphs 14 and 15 of Australian Accounting Standard AAS11, "Accounting for Construction Contracts", is appropriate.

Guideline

257. Paragraphs 14 and 15 of Australian Accounting Standard AAS11, "Accounting for Construction Contracts", are to be used as a guide when identifying the costs associated with the construction of an asset by a GTE for use in its own operations.

258. **Restricted Assets**. Information about restrictions imposed by legislation, government directives or other external means on the manner in which the GTE can deploy some of its assets may be relevant to assessments of such matters as the GTE's capacity for adaption or capacity to generate revenues. As such, information about the restrictions may be relevant to assessments of the performance, financial position or financing or investing of the GTE. Examples of such restrictions are where assets controlled by the GTE may be permitted to be deployed only in certain specified circumstances or may be required to be held in particular form for a specified minimum period.

259. In respect of assets which are recognised in the statement of financial position, the financial report should identify, by way of note, those assets the uses of which are restricted, wholly or partially, by legislation, government directive or other external means where those restrictions are relevant to assessments of the performance, financial position or financing or investing of the GTE. The value of those assets should be disclosed together with the nature of the restrictions.

Guideline

260. Where the uses of assets recognised in the statement of position are restricted by legislation, directives or other external means and those

restrictions are relevant to assessments of the performance, financial position or financing or investing of the GTE, disclosure is to be made of:

a. *the values of those assets; and*

b. the nature of those restrictions.

261. **Controlled Items**. GTEs also possess many relatively low valued items which do not qualify as assets, but because of their attractiveness and portability, are more likely to be misplaced or stolen. Loss of these items may constitute a significant expense of a GTE. To minimise what essentially becomes an expense to the relevant jurisdiction, it is necessary that such items have special management control. Each GTE should establish systems in respect of items with a value below the asset capitalisation threshold to ensure adequate management of those items.

Guideline

262. GTEs should establish systems to ensure adequate management of items with a value below the capitalisation threshold which, because of their attractiveness and portability, are more liable to be misplaced or stolen.

263. **Renewals Accounting**. The renewals approach to recognition of the consumption of the service potential or future economic benefit of assets treats a collection of assets making up a network or system as a single asset which is to be maintained indefinitely. All expenditures on an asset system whether replacing or maintaining existing service potential or future economic benefits are perceived to be in the nature of maintenance of the system and are expensed as they occur. Therefore, under renewals accounting, depreciation of these types of systems is not recognised.

264. Underlying renewals accounting is the assertion that expenditure made to maintain a system in operation is an adequate representation of the cost of service potential or future economic benefit consumed. However, in practice this may not be the case for the following reasons:

a. major replacement expenditure in larger and/or steady state systems often occurs in a lumpy or infrequent manner over time creating differences between the expenditure in a particular period and the expense of the service potential or future economic benefits consumed; and

b. for many network or system assets, a major factor contributing to the decline in service potential or future economic benefits is wear and tear through physical use. However, technical or commercial obsolescence can also be a significant factor in this decline and renewals accounting does not adequately account for such changes in service potential.

265. By focussing on the perceived longevity of assets systems to the disregard of changing service potential or future economic benefit of its component assets, renewals accounting assumes that the amount of the service potential or future economic benefit inherent in the asset system will remain stable and, in doing so, fails to provide a mechanism by which that assumption can be tested against the entity's experience.

269. The use of renewals accounting by GTEs is not supported in these Guidelines as it does not result in the provision of information that is relevant to the assessment of GTE performance and financial position.

Guideline

270. "Renewals accounting" is not permitted in relation to reporting for GTE performance monitoring purposes.

271. **Capital and Maintenance Expenditure**. A significant practical issue which has been confronted by reporting entities in both the public and private sectors is the classification of expenditures between those which give rise to increases in assets and those which can be classified as expenses. In concept, expenditures on maintenance, repairs and overhauls relating to long lived assets give rise to service potential or future economic benefits. Strict application of this concept would, in principle, require such expenditures to be capitalised and subsequently expensed via depreciation. However, the Guidelines permit immediate recognition of expenditure on maintenance, repairs and overhauls as an expense when the result of this practice is not materially different from applying that concept.

272. **Capitalisation Criteria**. To assist in the consistent application of this approach on a practical and cost effective basis, the following criteria are adopted in these Guidelines as the normal basis for classifying expenditures in respect of non-current assets between those which should be recognised as increases in assets and those which should be recognised as expenses:

a. expenditure on an existing non-current asset should be recognised as an increase in the asset where material and:
   (i) the expenditure results in an effective increase in the present or planned service capacity of the asset which will be utilised; or
   (ii) there has been an effective increase in the quality of the services provided by the asset beyond that previously determined; or
   (iii) there has been an effective extension to the asset's useful life as a result of the expenditure; and
b. where none of these criteria are met, the expenditure should be classified as an expense, except where maintenance is scheduled (in accordance with

a maintenance program) over a number of reporting periods or has previously been deferred in respect of a depreciable asset and its carrying amount has been written down by way of an adjustment to accumulated depreciation to reflect maintenance scheduled to be undertaken less frequently than once a year or the deferral of maintenance. In these cases when maintenance is undertaken the accumulated depreciation (or provision for major periodic maintenance) is to be reduced by the amount of the cost of restoration and expenditures in excess of amounts that have been previously charged as depreciation or provision for major periodic maintenance are to be reported as a maintenance expense in that period.

Guideline

270. Expenditure on an existing non-current asset is to be capitalised only when it is material and produces an effective increase in the present or planned service capacity of the asset which will be utilised or an effective increase in the quality of the asset's services or effectively extends the useful life of the asset. Other expenditure on repairs and maintenance is to be classified as expenses except where the expenditure is material and is in respect of maintenance scheduled to occur less frequently than once a year or scheduled maintenance that has been deferred beyond year end in which case it is to be accounted for in accordance with paragraph 273 of these Guidelines.

271. **Future and Deferred Maintenance**. Where major maintenance is scheduled (in accordance with a maintenance program) over a number of reporting periods or is deferred to future reporting periods, an issue which arises is how the effect of such maintenance should be accounted for. Some entities have recognised provisions for maintenance as liabilities. These Guidelines do not permit those items to be recognised as a liability in the statements of financial position prepared for performance monitoring purposes. Instead, they require that, where the effect is material, the depreciation expense recognised during each reporting period until the maintenance is performed should take into account the consumption or loss of service potential or future economic benefits which results from the cyclical nature or the deferral of maintenance. This recognition of the effects of such cyclical or deferred maintenance would occur until the date that the maintenance is performed. Alternatively, a separate provision for major periodic maintenance expense may be recognised in each reporting period with a corresponding amount being shown as a deduction from the carrying amount separately from accumulated depreciation.

272. When the major cyclical or deferred maintenance is carried out it will be necessary to adjust the written-down value of the asset to accurately reflect the restoration of the remaining service potential or future economic benefits. This should be done by adjustment of the accumulated depreciation or provision for

periodic maintenance by the amount of the cost of the restoration. Expenditures in excess of amounts that have been charged as depreciation or provision for major periodic maintenance expense are to be reported as maintenance expenses in that period.

Guideline

273. Where major cyclical maintenance is scheduled (in accordance with a maintenance program) over a number of reporting periods or maintenance is deferred to future reporting periods, the depreciation expense (or provision for major periodic maintenance expense if applicable) recognised during each reporting period until the maintenance is performed is to take into account the consumption or loss of service potential or future economic benefits. When the cyclical or deferred maintenance is carried out the accumulated depreciation (or provision for major periodic maintenance) is to be adjusted by the amount of the cost of the restoration. Expenditure in excess of the amounts that have been charged as depreciation or provision for major periodic maintenance expense are to be reported as a maintenance expense in that period.

274. **Disclosure of Deferred Maintenance**. The Sub-committee considers that, where material, future maintenance expenditure resulting from a deferral of previously planned maintenance should be disclosed by way of note. Such a note would include the details of any projected material effect on the future capacity or useful life of the asset.

Guideline

275. The amount of future maintenance expenditure arising from a deferral of previously planned maintenance expenditure is to be disclosed by way of note. The note is to include the details of any projected material effect on the future capacity or useful life of the asset or assets.

276. **Classification of Assets**. Except as addressed earlier in this discussion paper, there is seen to be no specific classification of assets requirement for performance monitoring purposes and none is proposed. However, GTEs should apply the provisions of AAS10 when determining classification of assets to be disclosed.

Guideline

277. Except for those classifications discussed earlier, no specific classification of assets is required. However, the provisions of Australian Accounting Standard AAS10, "Accounting for the Revaluation of Non-Current Assets", are to be applied.

278. Accounting for Shared Assets. To ensure completeness of reporting it is essential that all assets be reported and this means that each asset only be

reported by one entity. Where the use of assets is shared, the prime control of the service potential or economic benefits should be used to determine the controlling entity. Other users would generally pay the controlling entity for the use of the asset. This may be particularly relevant in the water supply and forestry industries. User charging of other entities utilising the asset should ensure performance reporting remains accurate and relevant. Entities which utilise shared assets should establish with other users which entity is the reporting entity in respect of those assets. Partial reporting of an asset is not allowable. Where it can be argued that no one entity has prime control of an asset since all have equal control and ownership interests, the entities are to ensure that the asset is reported by one of the entities.

Guideline

279. Each asset is to be reported by the entity that has prime control of the service potential or future economic benefits embodied in the asset. Where it can be argued that no one entity has prime control of an asset since all have equal control and ownership interests, the entities are to ensure that the asset is reported by one of the entities.

DISCLOSURE REQUIREMENTS

280. As addressed elsewhere, the Sub-committee has agreed that a number of disclosures in the notes to GTE's financial reports are required to enhance the comparability of performance between GTEs. These disclosures provide information not available elsewhere and aid the comparisons of the relative efficiency of like enterprises.

Guideline

281. In addition to the disclosures specified in Australian Accounting Standards, the following summarises the disclosures required in the notes to GTE financial reports for performance monitoring purposes:

a. the asset capitalisation and revaluation thresholds adopted;

b. in respect of each class of asset:

(i) the effects of the initial application of the recoverable amount test where the test is first applied under these Guidelines;

(ii) where the use of assets recognised in the statement of financial position are restricted, wholly or partially by legislation, government directives or other external means and those restrictions are relevant to assessments of the performance, financial position or financing or investing of the GTE, disclosure is to be made of the value of those assets together with the details of the nature of those restrictions;

(iii) deferred maintenance expenditure including the projected material effect on the assets future capacity or useful life; and

(iv) details of those assets not recognised in the statement of financial position due to "reliable measurement" criteria not being met.

(v) where a parcel of land held for continued use (that would be replaced) is included in the statement of financial position at its 'current market value' (based on its feasible alternative use) and this is materially greater than its deprival value, both values of that land must be disclosed in a note.

IMPLEMENTATION ISSUES

282. It is realised that there may be a number of implementation issues including costs, system deficiencies and training requirements in moving to apply current value methodology to GTEs' non-current physical assets. However, it is considered that the benefits from the provision of more relevant, complete and comparable financial information as the basis for the performance monitoring of GTEs will far outweigh the costs and will also have considerable side benefits in the management of assets.

283. Common problems arising from implementation of valuation of assets at current value relate to obtaining reliable and consistent data at an acceptable cost. These may include:

a. limitations of systems and current cost asset records and registers;

b. practical valuation difficulties/issues both general or specific to GTEs; and

c. costs and resources required to implement the methodology.

284. To ensure the most cost effective transition to the asset valuation policy contained in these Guidelines, it will be necessary for each jurisdiction and GTE to ensure detailed planning is carried out and adequate resources are allocated.

Guideline

285. In adopting these Guidelines, the Commonwealth, State and Territory Governments need to recognise the requirement for technical assistance and adequate resources and assistance to enable their effective adoption.

APPENDICES

A. Definitions

B. Model Letter of Instruction to Valuers Engaged for the Purposes of valuing the Physical Assets of Government Trading Enterprises

C. List of Government Trading Enterprises

D. Summary of Use of Performance Indicators and their Relationships with Asset Values

E. Guidance for the Valuation of Other Assets

F. Bibliography of Reading Material

G. Members of the Asset Valuation Sub-committee for the National Performance Monitoring of GTEs

APPENDIX A DEFINITIONSERROR! NO BOOKMARK NAME GIVEN.

The policy guidelines are to be interpreted in the context of the following definitions.

Abnormal Items. Means items of revenue and expense included in the operating result/profit or loss after income tax for the reporting period, which are considered abnormal by reason of their size and effect on the operating result/profit or loss for the reporting period (Australian Accounting Standard AAS1, “Profit and Loss or Other Operating Statements")

Accumulated Depreciation. The aggregate, at a given point of time, of the depreciation charges made in respect of a particular depreciable asset or class of depreciable assets. (Australian Accounting Standard AAS4, “Depreciation of Non-current Assets")

Assets. Are service potential or future economic benefits controlled by the entity as a result of past transactions or other past events. (Statement of Accounting Concepts SAC4, “Definition and Recognition of the Elements of Financial Statements")

Carrying Amount.

(i) In relation to an asset, the amount at which the asset is recorded in the accounting records as at a particular date. In application to a depreciable asset, “carrying amount” means the net amount after deducting accumulated depreciation.

(ii) In relation to a class of assets, the sum of the carrying amounts of the assets in that class. (Australian Accounting Standard AAS10, “Accounting for the Revaluation of Non-current Assets")

Class of Non-Current Assets. A category of non-current assets having a similar nature or function in the operations of the entity, which category, for the purpose of disclosure in the financial report, is shown as a single item without supplementary dissection. (AAS10)

Community (or Social) Assets. Community assets are assets acquired for the benefit of the community at large. Some assets falling into this category are employed directly by an entity to deliver goods and services to members of the public,e.g. national parks and national monuments, while others may also be

employed in productive processes to deliver desired end products, typically on a less than cost recovery basis.

Community Service Obligations. A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices.

Comparability. That quality of financial information which exists when users of that information are able to discern and evaluate similarities in, and differences between, the nature and effects of transactions and events, at one time and over time, either when assessing aspects of a single reporting entity or of a number of reporting entities. (Statement of Accounting Concepts SAC3, "Qualitative Characteristics of Financial Information")

Control (of an asset). The capacity of the entity to benefit from the asset in pursuit of the entity's objectives and to deny or regulate the access of others to that benefit. (SAC4)

Current Assets. Cash or other assets of the entity that would in the ordinary course of operations of the entity be consumed or converted into cash within 12 months after the end of the last reporting period of the entity. (AAS10)

Current Cost. The cost of an asset measured by reference to the lowest cost at which the gross "service potential" of that asset could currently be obtained in the normal course of business. (Statement of Accounting Policy SAP1, "Current Cost Accounting")

Current Market Buying Price. The amount for which an asset with similar service potential could be bought by a knowledgeable, willing buyer from a knowledgeable, willing seller in an arm's length transaction at current prices plus the buyer's transaction costs. This equates to current market value plus the buyer's transaction costs.

Current Market Value. The price that a willing but not anxious seller would accept from a willing but not anxious buyer for an asset in an arm's length transaction at current prices. This does not include transaction costs.

Current Replacement Cost. This relates to a current cost estimated as the cost per unit of service potential of the most appropriate modern replacement facility. It applies where the asset being valued can not be replaced by an asset with the same service potential and would be replaced at balance date by a different asset (in terms of scale and/or technology) having a similar service

potential which would be used as a reference for determining the replacement cost per unit of service potential of the existing asset.

Current Reproduction (Replication) Cost. This relates to a current cost by reference to the cost per unit of service potential of reproducing or replicating the unit. It applies where the asset being valued would be replaced at balance date by a similar asset in terms of both scale and technology.

Depreciable Amount. The historical cost of a depreciable asset, or other revalued amount substituted for historical cost, in the financial report, less in either case the net amount expected to be recovered on disposal of the asset at the end of its useful life. (AAS4)

Depreciable Asset. A non-current asset having a limited useful life. (AAS4)

Deprival Value. Deprival value is described as the cost to an entity if it were deprived of an asset and was required to continue to provide goods and service or deliver programs using that asset. Under this approach, assets are valued at an amount that represents the entire loss that might be expected to be incurred if the entity were deprived of the service potential or future economic benefits of these assets at the reporting date. Thus the value to the entity in most cases will be measured by the replacement costs of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the replacement cost represents the amount of cash necessary to obtain an equivalent or identical asset.

Depreciation Expense. An expense recognised systemically for the purpose of allocating the depreciable amount of a depreciable asset over its useful life. (AAS10)

Entity. Any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives. (Statement of Accounting Concepts SAC1, “Definition of the Reporting Entity")

Equity. The residual interest in the assets of the entity after deduction of its liabilities. (SAC4)

Expenses. Consumptions or losses of service potential or future economic benefits in the form of reductions of assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period. (SAC4)

Extraordinary items. Means items of revenues and expense which are attributable to events or transactions of a type that are outside the ordinary operations of the reporting entity and are not of a recurring nature. (AAS1)

Fair Value. The amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. (Australian Accounting Standard AAS21, "Accounting for the Acquisition of Assets (Including Business Entities)")

General Purpose Financial Report. A financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs. (SAC1)

Heritage Assets. No generally accepted formal definition of these is available. However, they can be described as those assets which a Government has decided to preserve for duration of their physical life because of their unique historical, geographical, cultural or environmental attributes.

Historical Cost. The historical cost of the asset is the original cost of the purchase, delivery and installation of an asset (including pre and post-installation capital expenditure). It may include absorption of overhead costs and, where applicable the interest costs during construction.

Infrastructure Assets. As in the case of heritage assets, no generally accepted formal definition of these is available; however, they can be described as those assets which are integral to public facilities that provided essential public services.

Inventories. Goods, other than property and services:

(i) held for sale in the ordinary course of operations,

(ii) in the process of production for such sale, or

(iii) to be used up in the production of goods, other property or services for sale including consumable stores and supplies, but does not include depreciable assets as defined in Australian Accounting Standard AAS4, Depreciation of Non-current Assets.

Liabilities. The future sacrifices of service potential or future economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other events. (SAC4)

Current Market Value. The price that a willing but not anxious seller would accept from a willing but not anxious buyer for an asset in an arm's length transaction at current prices. This does not include transaction costs.

Net Present Value (Discounted Cash Flow). The value of an asset to the entity from the continued use and subsequent disposal in present monetary values. It is the net amount of discounted total cash inflows arising from the continued use and subsequent disposal of the asset after deducting the value of the discounted

total cash outflows arising therefrom. The discount rate employed should be no less than the risk free rate i.e. the earning rate of Commonwealth securities.

Non-current Assets. All assets other than current assets. (AAS4)

Operating Assets. Operating assets are those assets which are used by an entity to produce and deliver goods and services to the public. Operating assets are employed in productive processes to deliver desired end products.

Opportunity Cost. The value of the most attractive alternative that is sacrificed by taking a proposed action. In relation to assets, opportunity cost is the value of the next best alternative that is sacrificed by retaining an asset.

Physical Assets. These are items which satisfy the criteria of assets and also have identifiable physical form i.e. they can be measured using a linear base.

Recoverable Amount. In relation to an asset, the net amount that is expected to be recovered through the cash inflows and outflows resulting from its continued use and subsequent disposal. (AAS10)

Relevance. That quality of financial information which exists when that information influences decisions by users about the allocation of scarce resources by:

(i) helping them form predictions about the outcomes of past, present and future events, and/or

(ii) confirming or correcting their past evaluations,

and which enables users to assess the rendering of accountability by preparers. (SAC3).

Reliability. That quality of financial information which exists when that information can be depended upon to represent faithfully, and without bias or undue error, the transactions or events that it either purports to represent or could reasonably be expected to represent. (SAC3)

Reporting Entity. An entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources. (AAS10)

Restricted Use Assets. Assets which are subject to legal or natural restrictions on their use. The basis for the restriction may be:

(i) inherent in the asset itself,

(ii) imposed by the government or law,

(iii) imposed by a donor or grantor, or

(iv) imposed by the controlling entity.

Revaluation. The act of recognising a reassessment of values of non-current assets at a particular date. (AAS10)

Revenue. Inflows or other enhancements, or savings in outflows, of service potential or future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period.

Service Potential. In relation to an asset, is its economic utility to the entity, based on the total benefit expected to be derived by the entity from the use (and/or through sale) of the asset. (SAP1)

Understandability. That quality of financial information which exists when users of that information are able to comprehend its meaning. (SAC3)

Useful Life. In relation to a depreciable asset, means the estimated total period from the date of acquisition, over which the service potential of an asset is expected to be used up in the business of the entity. (SAP1)

Written Down Value. As for “Carrying Amount".

APPENDIX B MODEL LETTER OF INSTRUCTION TO VALUERS ENGAGED FOR THE PURPOSES OF VALUING THE PHYSICAL ASSETS OF GOVERNMENT TRADING ENTERPRISES

1 January 1995

Assess, Measure and Evaluate Pty Ltd
Licensed Valuers
Southern Cross Avenue
Australiaville AUST 0000

Dear Sir/Madam

The (name of authority) is required to revalue its non-current physical assets to enable it to prepare financial reports for use under an agreed National Performance Monitoring Regime for Government Trading Enterprises.

The financial statements to be prepared will be audited and are intended to provide information to a range of users to assist them in:

- making and evaluating decisions about the allocation of resources by the authority;
- assessing the financial performance and position of the authority; and
- discharging managerial accountability.

Attached are details of those assets to be valued, separately identifying assets which are surplus to requirements and assets where the service potential would not be replaced if the GTE was to be deprived of the assets.

The approach to valuation should be based upon the following:

Surplus Assets

- Infrastructure, plant, equipment, buildings and other improvements (other than land) which are surplus and are to be sold separately from the land should be valued at their market value.

- Land (including improvements) which is surplus should be valued at market value based upon its highest and best use.

Assets Held for Continued Use Which Would be Replaced if the GTE was Deprived of the Assets

- Infrastructure, plant, equipment, buildings and other improvements which are held for continued use and for which there is a secondary market (i.e. non-specialised property) should be valued at their gross current market buying price. Where the assets are not normally acquired in a secondary market, the price of a new asset is relevant to determining the value of the asset and where the assets are normally acquired in a secondary market, the price of a second hand asset is relevant to determining the value of the asset.
- Infrastructure, plant, equipment, buildings and other improvements which are held for continued use and for which there is no secondary market (i.e. specialised property) should be valued at the lower of the gross current replacement cost and the gross current reproduction cost of the service potential of the existing asset.
- Land (excluding improvements) held by the authority for continued use should be valued at the greater of:
  (a) current market buying price, taking into account the nature of the parcel, the legal restrictions on use, the opportunities for and impediments to development that are inherent to the specific parcel of land, other constraints that exist in respect of that land and any special attributes that the land may possess (value in use); and
  (b) current market value based on its feasible alternative use taking account of the costs of achieving the alternative use.

It is to be noted that, in the above cases the value of the gross service potential is required.

Assets Held for Continued Use Which Would Not be Replaced if the GTE was Deprived of the Assets

These assets are to be valued at the greater of the net present value and the current market value.

Heritage Assets

- Where the service potential of the asset can and would be replaced in the future, it should be valued based on the current cost of the service potential of the asset. In those cases where the asset has a land component, that component should be valued in the same way as non-heritage land held for continued use.

- Where the service potential of the asset would not (or cannot) be replaced, market value should be adopted if it can be reliably determined with reference to markets for comparable assets.
- Where the asset is irreplaceable and the market value cannot be determined reliably, it should not be assigned a value. Information relevant to decision making purposes, however, should be disclosed as a note in the financial statements (e.g. the quantum and the nature and functions of the asset together with the annual costs of maintenance, where applicable).

Yours sincerely

(This Letter of Instruction has been developed by the Asset Valuation Sub-committee for the National Performance Monitoring of Government Trading Enterprises in conjunction with Australian Government Valuers and the Institute of Valuers and Land Economists, with the aim of assisting valuers in providing consistent valuation of assets for GTEs.)

LIST OF PARTICIPATING GOVERNMENT TRADING ENTERPRISES BY JURISDICTION

Jurisdiction/Enterprise	*Industry classification*
NEW SOUTH WALES	
Pacific Power	Electricity
Hunter Water Corporation	Water
Maritime Services Board of New South Wales	Ports
Illawarra Electricity	Electricity
Prospect Electricity	Electricity
Shortland Electricity	Electricity
State Rail Authority of New South Wales	Railways
State Transit Authority	Urban Transport
Sydney Electricity	Electricity
Sydney Water Board	Water
VICTORIA	
Gas and Fuel Corporation of Victoria	Gas
Melbourne Water	Water
Port of Melbourne Authority	Ports
Public Transport Corporation	Urban Transport/Rail
State Electricity Commission of Victoria	Electricity
QUEENSLAND	
Dept of Water Supply and Sewerage	Water
Gladstone Port Authority	Ports
Port of Brisbane Authority	Ports
Queensland Electricity Commission	Electricity
South East Queensland Electricity Commission	Electricity
Capricornia Electricity	Electricity
Queensland Rail	Railways
DPI Water Resources	Water
Brisbane Transport	Urban Transport
SOUTH AUSTRALIA	
Department of Marine and Harbours	Ports
Pipelines Authority of South Australia	Gas
State Transport Authority of South Australia	Urban Transport
Electricity Trust of South Australia	Electricity
Engineering & Water Supply Department	Water

(Continued on next page)

Jurisdiction/Enterprise	*Industry classification*
WESTERN AUSTRALIA	
Fremantle Port Authority	Ports
State Energy Commission of Western Australia	Electricity/Gas
Transperth	Urban Transport
Water Authority of Western Australia	Water
Westrail	Railways
TASMANIA	
Burnie Port Authority	Ports
Hobart Regional Water Board	Water
Hydro-electric Commission	Electricity
Marine Board of Hobart	Ports
Metropolitan Transport Trust	Urban Transport
Rivers and Water Supply Commission, North Esk	Water
North West Regional Water Authority	Water
Port of Devonport Authority	Ports
Port of Launceston Authority	Ports
NORTHERN TERRITORY	
Darwin Port Authority	Ports
Power and Water Authority	Electricity/Water
AUSTRALIAN CAPITAL TERRITORY	
ACT Electricity and Water	Electricity/Water
ACTION	Urban Transport
COMMONWEALTH	
Australian National Railways Commission	Railways
Australian National Line Limited	Other Commonwealth
Australia Post	Other Commonwealth
Federal Airports Corporation	Other Commonwealth
Telecom Australia	Other Commonwealth
Snowy Mountains Hydro-electric Authority	Electricity
The Pipeline Authority	Gas
Civil Aviation Authority	Other Commonwealth
Australian Maritime Safety Authority	Other Commonwealth

APPENDIX D SUMMARY OF USE OF PERFORMANCE INDICATORS AND THEIR RELATIONSHIP WITH ASSET VALUES

Objective

The objective of this Appendix is to outline the purpose of performance indicators and the place of non-current physical asset values in the financial indicators proposed by the Steering Committee on National Performance Indicators for Government Trading Enterprises (GTEs) to measure the performance of GTEs.

Types of Performance Indicators

The performance indicators are both financial and non-financial. However, even in the case of the latter, a number include financial components as well as non-financial components.

Purpose of Performance Indicators

Performance indicators provide a basis for comparing the performance of an entity over time with similar types of entities and with appropriate industry standards. In the case of each entity, further work would be required to determine the actual causes of any variations of its indicators from those of other entities or industry standards. The purpose of each of the relevant performance indicators is indicated in the following Table.

Revenue, Expense and Depreciation

Although definitions of terminology are contained in Appendix A, before actually discussing the derivation of the performance indicators and the use of asset values, it is necessary to clarify the meanings of a number of the terms in this context.

Costs and expenditure are used in a number of performance indicators. The terms are generally interchangeable with expense(s) and the main reason for the different terminology lies in their derivation through common use in different industries.

Operating expenses are those expenses incurred by an entity during the ordinary course of operations and include depreciation expenses and interest expenses resulting from the financing of those operations. They also include abnormal items.

“Abnormal items means items of revenue and expense included in the operating result/profit or loss after income tax for the reporting period, which are considered abnormal by reason of their size and effect on the operating result/profit or loss for the reporting period. (Australian Accounting Standard AAS1, “Profit and Loss or Other Operating Statements")

Extraordinary items means items of revenues and expense which are attributable to events or transactions of a type that are outside the ordinary operations of the reporting entity and are not of a recurring nature. (AAS1)

When a non-current physical asset is purchased to generate future revenue, it is necessary that the cost of that asset be apportioned over the period in which it will continue to generate the revenue. This is done by the application of “depreciation expense” in each reporting period.

To accurately reflect the remaining value of an asset once depreciation expense has been charged in respect of an asset, it is necessary to write down the amount at which the asset is reported. This is done by aggregating the depreciation expenses over the expired life of the asset to calculate the “accumulated depreciation” which is then subtracted from the asset value to give the “carrying amount” or “written down value” which is used for reporting of asset values.

Use of Asset Values in the Performance Indicators

The following Table indicates that nearly all of the proposed performance indicators utilise asset values either directly as bases or indirectly through the use of depreciation expenses to arrive at bases.

The various uses of asset values in the performance indicators are comprehensively set out in the Table.

Conclusion

As asset values are used to calculate nearly all of the financial performance indicators it is very essential that the basis of valuation of assets and the application of depreciation thereto be consistent for similar GTEs to ensure that the use of the performance indicators produces comparable results.**Table - Performance Indicator Construction and Purpose**

Performance Indicator Construction and Purpose

Error! No bookmark name given.Performance Indicator	**Purpose of Indicator** (Note that, in addition to the purposes below, each performance indicator provides the basis for comparison between similar organisations)	**Definition** (Provided by the Steering Committee)	**Relationship of Asset Values to Performance Indicator**
Return on Assets (%)	Measures the return on total funds employed and hence the profitability of the total investment in the organisation.	Earnings before interest and tax (EBIT) Average total assets	Depreciation expense, based on asset values, is used to calculate earnings. Direct use of asset values.
Return on Operating Assets (%)	Measures the return from operations on the assets used in operations.	EBIT less investment income Average total assets - average financial assets	Depreciation expense, based on asset values, is used to calculate earnings. Direct use of asset values.
Operating Sales Margin or Return on Sales (%)	Indicates the profitability of the business and also provides a measure of efficiency.	EBIT - investment income Total Revenue - investment income	Depreciation expense, based on asset values, is used to calculate earnings.
Return on Equity (%)	Indicates the total earnings on the shareholder total (accrued) investment in the entity.	Operating profit after tax Average total equity or Operating profit after tax Ave. Total Assets - Ave. Total Liabilities	Depreciation expense, based on asset values, is used to calculate operating profit. Equity is the difference between the total assets and the total liabilities.
Dividends to Equity Ratio (%)	Measures the return to shareholders from the investment in the entity.	Dividends Paid or Provided For Average Total Equity or Dividend Paid or Provided For Ave. Total Assets - Ave. Total Liabilities	Equity is the difference between the total assets and the total liabilities.

Performance Indicator	Purpose of Indicator	Definition	Relationship of Asset Values to Performance Indicator
Dividend Payout Ratio or Dividend Payable to Profit (%)	Measures the retention of profits by the organisation.	Dividend paid or provided for / Operating profit after tax	Depreciation expense, based on asset values, is used to calculate operating profit.
Debt to Equity (%)	Measures the extent to which the organisation is financed by external debt. The higher the ratio, the greater financial risk borne by the creditors and hence the greater care required in lending to the organisation.	Debt / Total equity or Debt / Total assets - total liabilities	Equity is the difference between total assets and total liabilities. Direct use of asset values.
Total Liabilities to Equity (%)	Indicates the possible risk of loss of investment to the shareholders.	Total Liabilities / Total Equity or Total Liabilities / Total assets - total liabilities	Equity is the difference between total assets and total liabilities.
Current Ratio or Current Assets to Current Liabilities (%)	The working capital ratio which indicates the amount of short term assets available to meet the short term liabilities and provides an indication of the safety margin afforded to current creditors.	Current assets / Current liabilities	Direct use of asset values.
Interest Cover or Profit to Interest (%)	Measures the ability of the organisation to meet its interest expense from income and, hence, indicates the income cover afforded to investors.	EBIT / Gross interest charges	Depreciation expense, based on asset values, is used to calculate net EBIT.

Performance Indicator	Purpose of Indicator	Definition	Relationship of Asset Values to Performance Indicator
Cost recovery ratio (%)		Revenue from operations / Expenses from operations	Depreciation expense, based on asset values, is used to calculate net expenses.
Operational Performance (%)		Revenure from operations - expenses from operations / Ave. Total Assets - Ave. Financial Assets	Depreciation expense, based on asset values, is used to calculate net expenses.
Earnings Before Interest and Tax ($,000)	Provides an indication of the size of the GTE and stability of the income stream and is used as a base for other performance indicators	Net operating profit before the deduction of interest and tax expenses	Depreciation expense, based on asset values, is used to calculate net EBIT.
Earnings Before Interest and Tax Less Investment Income ($,000)	Provides an indication of the size of the GTE and stability of the income stream from operations and is used as a base for other performance indicators	Net operating profit before the deduction of interest and tax expenses less revenue from investments	Depreciation expense, based on asset values, is used to calculate operating profit.
Operating Profit Before Tax and After Abnormals ($,000)	Provides an indication of the size and stability of the operating profit	Net operating profit plus abnormals before the deduction of tax expense	Depreciation expense, based on asset values, is used to calculate operating profit.
Dividends Paid or Provided for ($,000)	Provides an indication of the dividends appropriated for the owners and is used as a base for other performance indicators	Total of dividends approved in the reporting period for distribution whether paid or not	Dividends are a distribution of profit Depreciation expense, based on asset values, is used to calculate operating profit.
Total Assets ($,000)	Provides an indication of the size of the GTE at reporting date	Total written down value of all assets at the reporting date	Direct use of asset values. Used as a basis for calculating other ratios.
Average Total Assets ($,000)	When compared with Total Assets, provides an indication of changes in investment in assets	Average of total written down value of all assets over the reporting period	Direct use of asset values

Performance Indicator	Purpose of Indicator	Definition	Relationship of Asset Values to Performance Indicator
Average Total Assets Less Average Financial Assets ($'000)	Provides an indication of the assets employed by the GTE in operations	Average of total written down value of all assets over the reporting period less average of value of all financial assets over the reporting period.	Direct use of asset values.
Current Assets ($,000)	Provides an indication of the assets expected to be used up in the 12 months after the reporting date and provides the base for other performance indicators	Total value of current assets at the reporting date.	Direct use of asset values.
Total Equity ($,000)	Provides an indication of the Government's net investment in the GTE at reporting date	Total assets - total liabilities	Direct use of asset values
Average Total Equity ($,000)	When compared with Total Equity, provides an indication of changes in the Government's net investment in the GTE	Average total assets - average total liabilities	Direct use of asset values

APPENDIX E GUIDANCE FOR THE VALUATION OF OTHER ASSETS

The valuation methodology developed by the Sub-committee for the Valuation of Non- Current Physical Assets specifically addresses non-current *physical* assets.

The following provides a brief reference of accounting pronouncements and guidance releases that may assist in establishing appropriate accounting treatment for current assets and non-current non-physical assets.

Identifiable Intangible Assets

Items such as patents and brand names are able to be identified as having value. There is no specific guidance on accounting for these assets following the withdrawal of Exposure Draft ED49. The appropriate accounting treatment for intangibles for specific entities will need to be developed from the relevant accounting pronouncements that are available. Guidance is found in:

- Statement of Accounting Concepts SAC4, “Definition and Recognition of the Elements of Financial Statements";
- Australian Accounting Standard AAS4, “Depreciation of Non Current Assets"; and
- Australian Accounting Standard AAS10, “Accounting for the Revaluation of Non-current Assets".

Many intangible assets do satisfy the SAC4 definition and recognition criteria for assets.

The general practice relating to identifiable intangible assets, such as trade marks and patents, is to treat them as depreciable assets, bringing them to account at either historical cost or other current valuation and amortising them over their estimated useful lives as outlined in AAS4.

As for non-current physical assets, identifiable intangible assets can be revalued as outlined in AAS10.

The Australian Accounting Research Foundation (AARF) has advised that there is no planned intention to re-issue a revised exposure draft in the near future. Professional bodies from overseas jurisdictions are exploring the issue of accounting for identifiable intangible assets. At this stage AARF recognises the importance of any overseas development on this issue and is maintaining contact on any developments that are occurring.

Unidentifiable Intangible Assets

Guidance on the accounting treatment for goodwill is provided in Australian Accounting Standard AAS18, “Accounting for Goodwill” and also in Australian Accounting Guidance Release AAG5, “Accounting For Intangible Assets Recognised in Accordance With AAS18".

Internally generated goodwill is usually not brought to account until a value is determined upon disposal when there is an exchange transaction. This is due to the difficulty or impossibility of identifying the events or transactions which contribute to the overall goodwill of the entity.

Valuation. Purchased goodwill should be measured as the excess of the purchase consideration plus incidental expenses over the fair value of identifiable net assets acquired. When recognised purchased goodwill should be amortised by systematic charges against income over the period of time during which the benefits are expected to arise.

Specific disclosure of goodwill in accordance with AAS18 is only required where the amounts involved are material.

Marketable Securities

Marketable securities are those securities quoted at the stock exchange such as shares bonds, notes and debentures.

Guidance on marketable securities is found in Accounting Guidance Release AAG9 “Accounting for Marketable Securities in the Context of Statements of Accounting Standard (AAS2) “Accounting for Inventories in the context of Historical Cost System", and AAS10".

AAG9 also provides assistance on accounting for marketable securities particularly in circumstances where there has been a downturn in the price of marketable securities. The Guidance Release refers to requirements based on AAS2 and AAS10. Marketable securities can be held as inventory or as non-current assets. The guidance release distinguishes between the two.

Valuation. There is a general accounting presumption that assets ought not to be carried at amounts in excess of their recoverable amounts. The recoverable amount of an asset is the net amount that is expected to be recovered:

- from the total cash inflows less the relevant cash outflows arising from the continued use and through subsequent disposal; or,
- through its sale.

Cash flows may include dividends or interest, proceeds and costs of disposal, and portfolio management costs.

Marketable Securities Held as Inventory. The principle that marketable securities held as inventory ought not be carried at amounts in excess of their recoverable amount is reflected in AAS2. That standard requires that marketable securities held as inventory are to be valued at the lower of cost or net realisable value.

Marketable Securities Held as Non-Current Assets. Marketable securities held as non-current assets should not be carried at amounts in excess of their recoverable amounts. This principle is in AAS10.

Non-marketable Securities

Non-marketable securities are those securities for which there is no market, i.e, they can not be traded. AARF has issued Exposure Draft 59 ED59, “Financial Instruments", which gives guidance for valuation.

Inventories

AAS2 outlines the valuation methodology for inventory.

Valuation. Inventories shall be valued at the lower of cost or net realisable value on a item by item basis.

Cost shall be assigned to inventory by one of the four methods.

i. Specific identification

ii. Average (weighted) cost

iii. FIFO

iv. Standard Cost

Monetary Assets and Liabilities

Australian Accounting Guidance Release AAG10, “Measurement of Monetary Assets and Liabilities states the general principle which underlies the valuation of monetary assets and liabilities.

Valuation. In Australia, the general principle underlying the measurement of interest-bearing assets and liabilities is:

- Monetary assets and liabilities are to be measured at the present value of the cash flows associated with their service potential and eventual payment, such present value being determined by discounting the cash flows at the rate of interest implicit in the original contract or other arrangement. This principle is reflected in Australian Accounting Standard AAS17, “Accounting for Leases".

Research and Development

Costs incurred during the period on research and development should be deferred to future reporting periods only to the extent that future benefits are expected, beyond reasonable doubt, to equal or exceed those costs, any previously deferred costs, and any future costs necessary to give rise to future benefits.

Deferred research and development costs should be amortised over future accounting periods in order to match such costs with related benefits.

Research and Development Costs could include:

i. cost of materials and services consumed in research and development activities;

ii. the salaries, wages and other related costs of personnel engaged in research and development activities;

iii. the depreciation of equipment and facilities to the extent that they are used for research and development activities;

iv. the amortisation of other assets, such as patents and licences, to the extent that they are related to research and development activities;

v. costs incurred for the entity by other entities on research and development activities, and charged to the entity; and

vi. other costs that can be directly attributed to research and development activities and can be identified with specific projects.

Valuation. Research and development costs should normally be charged to expense as incurred, except to the extent that they may satisfy criteria for deferral. Where costs satisfy the criteria for deferral, the costs should be capitalised accordingly. The amount capitalised should be amortised over future periods in order to match the costs of the activities with the benefits which are derived from them.

AAS13 states that costs incurred on research and development should be deferred only to the extent that future benefits derived from those costs are expected beyond reasonable doubt, to exceed those costs, any previously deferred costs, and any future costs necessary to give rise to the future economic benefit.

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