3 August 2021

Australian Accounting Standards Board
Podium Level 14, 530 Collins Street
Melbourne VIC 3000

Dear Standards Board,

RE: ITC 45 new 'current operational value' measurement basis for non-cash generating assets in the public sector

The South Australian Local Government Financial Management Group (SALGFMG) is an active incorporated body which has over 200 members representing over 95% of all Councils in South Australia. The SALGFMG is well known as a leading industry advocate and has been involved in a number of projects to improve financial management practises across the industry.

On behalf of the SALGFMG we provide the following feedback in relation to the proposed new 'current operational value' measurement basis for measuring the current value of non-financial assets of not-for-profit public sector entities held primarily for their service potential, rather than their ability to generate net cash inflows (i.e. 'operational assets').

As per Local Government Act 1999 the functions of a council are to "provide services and facilities that benefit its area, its ratepayers and residents" and to provide "infrastructure for its community and for development within its area".

The role of CEO is to ensure that the "assets and resources of the council are properly managed and maintained".

In South Australia, Councils are the custodians of over $25 billion of infrastructure and other assets on behalf of their communities.

To achieve this purpose each Council is required to develop and adopt an infrastructure and asset management plan (I&AMP) and long term financial plan (LTFP) covering a period of at least 10 years. There is a direct link between the development and implementation of these two plans. The two plans need to be consistent. That is to say, the LTFP must reflect the optimal level of proposed asset maintenance, renewal and replacement outlays necessary to achieve the Council's specified service levels, while minimising whole-of-life-cycle asset costs, as specified in the Council's I&AMP.

The Council uses its asset data including asset condition, useful life and replacement cost to determine when assets should be renewed having regard to Councils ability to fund this renewal program whilst ensuring ongoing financial sustainability and maintaining intergenerational equity such that each generation of ratepayer is paying for their consumption of resources.

As per AASB 13 “Fair Value” is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

Hence market evidence should be used for determining valuations wherever such evidence exists. Where market evidence doesn’t exist fair value may need to be estimated by an income or depreciated replacement cost approach.

In local government there is no market for the majority of assets entrusted to it such as roads, stormwater, bridges, footpaths etc and consequently fair value is calculated as depreciated replacement cost.

This valuation methodology has a strong alignment to the infrastructure planning that a council undertakes to ensure the assets it is responsible for continue to deliver effective services.

However compliance with the requirements of AASB 13 is likely to present the most challenges in attempting to determine appropriate treatment of land and land with buildings or structures attached.

Market values naturally must reflect highest and best use but AASB 13 makes it clear that the current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

For local government, given assets are held primarily for their service potential, rather than their ability to generate net cash inflows (i.e. ‘operational assets’), we support a definition that suggests that the proposed new ‘current operational value’ measurement basis for measuring the current value of non-financial assets is a more meaningful valuation method as opposed to highest and best use by market participants.

Our support of this change is due to impact of:

1) Community land assets

We argue that all local government owned sites that are designated as ‘community land’ under the provisions of the Local Government Act don’t have a market value. By definition ‘community land’ cannot be disposed of unless and until the ‘community land’ classification is revoked. While there is a process to revoke community land, we believe until that process has been agreed by council, there is no market value, and highest and best use is its current use. It therefore follows that any buildings and other structures on the land should not be valued based on a market value either. Where such improvements don't exist primarily to generate income then replacement cost is an appropriate basis of valuation.

2) Highest and best use is interpreted widely and inconsistently by Valuers often resulting in building assets with nil fair value.

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

Some auditors / valuers interpret this to mean that the current use can generally be taken to be the highest and best use, whilst others suggest that Council could maximise the assets sale price (exit price) by selling the asset for an alternative use. These means the Valuer must identify the hypothetical potential highest and best use of a piece of land, and assume that buyers will use the asset for that purpose.

If the buyer would need to demolish any existing structures on land to achieve this hypothetical highest and best use, then the price they are willing to pay for the structures (the Fair value) is zero, or very little.

This is taking the buyers perspective, providing them with the highest and best use but minimising the current use from the perspective of Council (the seller).

For buildings that are condemned for demolition, this interpretation is not an issue.

It is however most critical for buildings in a perfectly good condition being utilised for a clearly Local Government specialised function, which reside on high-value land on which there may be perceived potential to develop a highly profitable commercial building.

The critical issue is should a fair value be assigned to the existing building on the basis of its current use, or on the basis that it is likely the building will be demolished by the buyer to make way for an alternative building?

We support the alternative approach which is to derive the fair value of the service potential of the existing asset based on the current use of the asset by the Council.

Councils have many assets such as depots, council civic buildings, libraries etc where although the market might assess there exists a 'better' use of the property, it is highly unlikely this assessment of a 'better' use will eventuate. If the council has not endorsed an alternate use of the property, valuing the building such as depots or council buildings based on its revenue earning potential can have serious political consequences which could be misleading to the ratepayers of the council and user of financial statements on the stewardship of its assets.

Especially when this assessment is based on a hypothetical alternate highest and best use and which often skews the fair value valuation to nil.

When this occurs there is no depreciation recorded for those assets, resulting in a distortion of the councils financial position and operating surplus/deficit, all the more problematic when the next valuer determines the highest and best use is its current use.

The objective of general purpose financial reports is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial reports also show the results of management's stewardship of the resources entrusted to it. However for a local council entrusted to look after the community's assets and ensure they continue to provide services in alignment with its I&AMP, the use of depreciated replacement costs and not market values based on highest and best use provides the most meaningful information for users in making decisions.

Thank you for the opportunity to provide input. We would welcome the opportunity for further consultation, to achieve a framework that is workable and in the best interests of all stakeholders.

Yours sincerely,

Elizabeth Williams
President