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Changes in Accounting Standards and Impact on Valuations in the Pacific

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Historical Inconsistencies

Since the implementation of accrual accounting in the public sector there has been significant inconsistencies regarding the interpretation and association application of a range of valuation related aspects of the IFRS and IPSAS standards.

For example, in Australia, over the past 20 years the level of inconsistency has been exacerbated as a number of jurisdictions mandating the revaluation model for the first time and issuing guidance which was not consistent with practices adopted in other jurisdictions or jurisdictions had not updated their guidance despite significant changes in the accounting standards.

Clear guidance on addressing these inconsistencies was recently addressed by the AASB publishing enhanced guidance to AASB13 Fair Value Measurement. The enhanced guidance and clarifications were based on extensive research and engagement undertaken by a special project for fair value in the public sector over the past six years.

Prior to the special project being created, in recognition of the inconsistencies and implementation of AASB13 which included a new definition and concept for fair value, CPA Australia developed detailed valuation guides in 2013 and 2016 which was developed through an extensive collaborative process including representatives from all jurisdictions and across a wide range of different roles including valuers, auditors and financial statement preparers.

The subsequent 'guides to the valuation and depreciation of public and NFP sector assets' were subsequently peer reviewed and published free of charge. The guidance material in the CPA guide is consistent with the updated AASB13 Fair Value Measurement.

Pacific Island Countries

Depending on whether and entity is a government department or agency or government owned enterprise, some pacific island countries adopt the IFRS standards (as done in Australia across all sectors) while others follow the IPSAS standards.

In recent years APV has undertaken a range of major projects across the pacific including the setting up of asset accounting and valuation frameworks in Vanuatu and Fiji, building internal capability for countries to undertake their own valuations, and undertaking major infrastructure valuations in Vanuatu, Fiji, Samoa and the Solomon Islands.

Our experience with these projects has highlighted that the pacific island countries also have struggled to deal with the changes in the accounting standards and as a result many of the reported valuations and depreciation expense calculations reported in financial statements may be misstated.

Changes in Accounting Standards

In 2013, the IFRS13 Measurement standard was implemented. This changed the definition and concept of Fair Value and replaced the Depreciated Replacement Cost approach with a new Current Replacement Cost approach. The change in requirement is subtle but significant and only recently have many auditors and valuers started to realise the impact of the changes. We note that many pacific island countries still use the DRC approach despite it being replaced with CRC over ten years ago.

When IFRS13 Fair Value Measurement was implemented, the IPSASB did not agree with the use of the new concept in the public sector. They subsequently developed a new Conceptual Framework (2016) and earlier in 2023 approved a new Measurement standard (IPSAS46) and Property Plant and Equipment standard (IPSAS45) which replaced the old IPSAS17 Property Plant and Equipment. For specialised public sector assets valued under the cost approach, IPSAS has implemented a new 'Current Operational Value' approach.

As a consequence, both the IFRS and IPSAS standards have clearly removed the old Depreciated Replacement Cost (DRC) approach as an acceptable method and any future valuations, especially of public sector or specialised infrastructure, need to be updated to reflect the changes.

While IFRS and IPSAS adopt different approaches to determine the replacement cost under their respective cost approaches, the process to get to the current value is exactly the same. Specifically, that the adjustment is an adjustment for 'obsolescence' based on economic, technical, functional and physical obsolescence and it is not an adjustment for depreciation. (ie. Not DRC based on useful life and RUL).

In simple terms the DRC approach approaches the determination of current value in the wrong order. In calculates a theoretical depreciation expense based on replacement cost divided by total useful life and then multiples the annual depreciation by an assessed RUL (often actual age less age-to-date) to calculate a theoretical Fair Value.

This approach fails to take into account condition and economic, functional, technical and physical obsolescence and directly breaches both IFRS and IPSAS standards by basing the calculation on depreciation.

In contrast, the correct order is to firstly determine the current value and then to calculate depreciation expense, after taking into account an residual value by dividing over the RUL.

Other standards that impact valuation

There are of course many standards that impact the valuation of assets depending on whether they are investment properties, held for sale, biological assets, inventory, etc. Additionally, consideration needs to be given to impairment events.

However, two standards that are often not considered, but have major impacts on valuation outputs are the requirements of depreciation under IAS16 / IPSAS45 and method of depreciation under IAS8 / IPSAS3. In particular, assets need to be separated into he different 'parts' that have a different useful life and depreciated separately. Additionally, if applying the straight-line method of depreciation, the correct calculation is (Carrying Amount less Residual Value) divided by the Remaining Useful Life.

The issue of what is a 'part' has also been subject to significant international review. As an example, the AASB Residual Value decision in 2015 confirmed that if the cost of renewal of a component (for example undertaking remedial renewal work on a road pavement) was less than the overall cost of the pavement, this highlighted the road pavement had two different parts with each required to be depreciated separately.

Impacts on Valuation

The resulting impact of these various accounting standards is that –

- DRC valuations are non-compliant with IFRS and IPSAS standards and future valuations need to be based on either CRC or COV approach depending on the appropriate accounting standards being adopted
- Under the cost approach –
    - Asset should be split into 'components' to assist with asset management planning
    - Each 'component' needs to be split into the different 'parts' with each part valued and depreciated separately
    - The value for each part needs to be determined based on an assessment of condition and obsolescence as appropriate. For example, if a component is to be renewed in a particular year the impact of obsolescence is more relevant than condition.
- Asset Registers may need some realignment to enable the correct calculation of depreciation expense. Typically, the asset register would record each 'component' as an asset and the depreciation expense would be calculated based a weighted average RUL calculated from the respective 'parts'.
- Asset Revaluation cycles should be improved so that comprehensive revaluations are undertaken every three years with desktop revaluations undertaken in each of the intervening years. This process, combined with good methodology, provides a mechanism to ensure consistent valuations from year-to-year and improved and integrated asset management.

If adopting the IFRS standards, there is also a vast array of additional disclosures required depending on whether the asset have been valued using level 1, 2 or 3 inputs. Most infrastructure is valued using the cost approach with level 3 inputs (assumptions) and will require extensive disclosure about how the values were derived and their reliability.

Are these changes practical?

While the changes sound overly complex and sophisticated, they are very easy to implement. With the right methodology. Once completed, they also provide extensive added-value to the asset management framework. For example, the data flowing from the valuation can be directly used to model future renewal projections, budgets and optimised asset management plans.

There are also many ways in which agencies can obtain a compliant valuation. They could –

- Contract an appropriately qualified and experienced valuation firm who specialise in public and not-for-profit sector asset valuation under the accounting standards (such as APV)
- Undertake an internal valuation using specialised financial reporting valuation software (such as Asset Valuer Pro)
- Use a collaborative approach where APV supports the entity over an extended period until the entity becomes fully self-reliant
- Use contractors or employees to undertake condition assessment and inventory validation by have APV deliver the valuation after verifying unit rates, etc.

About the Author

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David is an accountant (Fellow CPA Australia) with a valuation, audit and asset management background. He is internationally recognised as a leading expert in the valuation and depreciation of public sector assets. He is a regular presenter at national and international conferences and is a Director of APV Valuers and Asset Management.

He has been actively involved with both the asset accounting and asset management of public sector assets over the past 30 years. This has included –

- Author of CPA Australia's guides to the valuation and depreciation of public and NFP sector assets under the international (IFRS and IPSAS -2013) and Australian (2016) accounting standards.
- Member of the Australian Accounting Standards Board special project team for 'Fair Value in the Public Sector' (2017–22)
- Chair of the Public Sector Assets Collaborative Group which is a special interest committee of 'the Asset Institute'. The group is comprised of representatives of the peak bodies with an interest in the asset management of public sector assets.
- Member of 10 person international review panel for the IPWEA International Infrastructure Financial Management Manual (IIFMM) (2023)

Prior to joining APV in 2006 he spent over 20 years with the Queensland Audit Office where he –

- Held responsibility for the audit of Queensland's local government sector and water sectors
- Managed the audit office's 'Contract Auditors Section'
- Chaired the 'Asset Valuation and Audit Advisory Group'