

AVGN 1 VALUATIONS FOR USE IN AUSTRALIAN FINANCIAL REPORTS

This Guidance Note should be read in conjunction with International Valuation Application 1 (IVA 1) & International Valuation Guidance Note 8 (IVGN 8)

1.0 Introduction

1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members producing valuations of property, plant & equipment assets (including heritage and infrastructure assets) for use in Australian financial reports and to assist users of those financial reports to understand the basis upon which property, plant and equipment valuations are undertaken.

1.2 Objectives

The objectives of this Guidance Note are to:

- Provide guidance to Members when preparing property, plant and equipment asset valuations for use in financial reports; and
- Assist users of financial reports to understand the basis upon which property, plant and equipment asset valuations are undertaken.
- Address general concepts and principles for use in the preparation of valuations for use in financial reports.

1.3 Status of Guidance Notes

Guidance notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of the Valuation and Property Standards Manual.

1.4 Scope

This Guidance Note applies to Members valuing property, plant and equipment assets for use in Australian financial reports.

This Guidance Note does not apply where a valuation is undertaken for purposes other than for use in Australian financial reports.

1.5 Development of Accounting Standards

The development of accounting standards involves an extensive process, including the preparation and publication of discussion papers and exposure drafts, and extensive industry consultation, by the Australian Accounting Standards Board (AASB).

1.6 Relationship to Accounting Standards

Australian Standards issued by the AASB have the force of the Corporations Law.

1.7 Financial Statements

Financial statements report the assets, liabilities, equity, revenues, expenses (the "elements" of financial statements) and cash flows of the entity.

1.8 Materiality

Accounting Standards are subject to the concept of materiality which is defined to mean "in relation to information, that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity".

Members should reflect this concept when completing valuations for financial reporting purposes.

2.0 Accounting Framework

2.1 Introduction

The 2005 AASB accounting standards apply to annual reporting periods beginning on or after 1 January 2005. This Guidance Note has been developed to reflect with the adoption of the Australian equivalents to International Financial Reporting Standards.

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In the Australian context it is important to consider the relationship between Australian Standards and International Standards.

The International Accounting Standards Board (IASB) was charged with preparing a set of International Financial Reporting Standards in 2000. The intention was to develop a single set of Accounting Standards that would be accepted by capital markets worldwide.

The International Valuation Standards Committee (IVSC), has formulated and published, in the public interest, valuation standards and promotes those standards for worldwide acceptance and observance. IVSC valuation standards have been developed for the procedural guidance of the valuation of assets for a variety of purposes including for use in financial statements and to harmonise standards amongst the world states and bring uniformity.

The IVSC works closely with the IASB and other international bodies such as the International Federation of Accountants, International Organisation of Security Commissions and BASEL Committee on Banking supervision. The IVSC also provides advice and counsel relating to asset valuation to the accounting profession.

The IVSC has developed International Valuation Standards 7th Edition, 2005, the relevant sections of which comply with the International Financial Reporting Standards as at 1 January 2005. In its press release regarding the publication of its new standards dated 9 February 2005, the IVSC stated:

"In 2004 the International Accounting Standards Board (IASB) made a number of significant changes to the Accounting Standards concerned with Real Estate and other fixed assets as part of its own improvements project. The IVSC revised its standards for the 2005 edition to reflect these changes.

The two standards most affected by the revised International Financial Reporting Standards are International Valuation Application 1 – Valuation for Financial Reporting; and International Valuation Guidance Note 8 – The Cost Approach for Financial Reporting – DRC.

In Australia the Corporate Law Economic Reform Program Act of 1999 established the basis for new standard setting arrangements as a part of the Commonwealth Government's Corporate Law Economic Reform Program.

The Financial Reporting Council is responsible for the broad oversight of the process for setting accounting standards for use in for-profit and not-for-profit public and private sectors. The key function of the Financial Reporting Council is to advise the Commonwealth Government on the accounting standards setting process and development of International Financial Reporting Standards and to determine the broad strategic direction of the AASB.

The Financial Reporting Council is not able to influence the AASB's technical deliberations and hence the content of any particular accounting standards.

The International Financial Reporting Standards are adopted in Australia through the Australian equivalents to IFRSs made by the AASB.

The AASB accounting standards that affect the valuation of property, plant, and equipment are summarised as follows: -

- AASB 116 – Property Plant and Equipment;
- AASB 117 – Leases;
- AASB 136 – Impairment of Assets;
- AASB 140 – Investment Property;
- AASB 141 – Agriculture;
- AASB 3 – Business Combinations ; and
- AASB 5 – Non Current Assets Held For Sale and Discontinued Operation.

The table below shows the relationship between the previous and new standards:-

Previous Standards	Current Standards
AASB 1015 – Acquisition of Assets	AASB 3 – Business Combinations AASB 116 – Property Plant and Equipment
AASB 1021 – Depreciation	AASB 116 – Property Plant and Equipment
AASB 1041 – Revaluation of Non Current Assets	AASB 116 – Property Plant and Equipment
AASB 1008 – Leases	AASB 117 – Leases
AASB 1010 – Recoverable Amount of Non Current Assets	AASB 136 – Impairment of Assets
No Previous Standard	AASB 140 – Investment Property
AASB 1037 – Self-Generating & Regenerating Assets	AASB 141 - Agriculture
AASB 1042 – Discontinuing Operations	AASB 5 – Non Current Assets Held For Sale and Discontinued Operations.

2.2 International Valuation Standards

The International Valuation Standards Committee (IVSC) publication *International Valuation Standards 2005*, discusses the term Fair Value at paragraph 8.1 (Pgg 31-33) of General Valuation Concepts and Principles by stating:

“The expression market value and the term fair value as it commonly appears in accounting standards are generally compatible, if not in every instance exactly equivalent concepts. Fair value, an accounting concept, is defined in international financial reporting standards and other accounting standards as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction. Fair value is generally used for reporting both market and non-market values in financial statements. Where the market value of an asset can be established this value will equate to fair value.”

2.3 AASB 116 – Property, Plant and Equipment

This standard prescribes requirements for the recognition, measurement at recognition and

measurement after recognition, and de-recognition of property, plant and equipment assets. After recognition as an asset, an item of property, plant & equipment is measured using the cost model or the revaluation model (at fair value).

The objective of AASB 116 is to prescribe the accounting treatment of property, plant and equipment so that the users of any Financial Report may discern information about the entity's investments in its property, plant and equipment and any changes in such investments.

The standard also prescribes requirements for depreciation of property, plant and equipment assets.

AASB 116 is equivalent to IAS 16 Property, Plant and Equipment issued by the IASB.

Current Australian standards require heritage assets to be recognised as they satisfy the definition of property, plant and equipment.

Therefore AASB 116 applies to heritage assets.

2.4 Relationship with Other Standards

AASB 116 is related to other standards which consider the Fair Value concept in certain specific areas. Depending on the classification of an asset it may be necessary to consider asset valuation requirements of the following:-

- **AASB 117 – Leases;**

It is noted that AASB 117 may apply to the disposal of an asset by way of sale and leaseback. This is important in considering the valuation of an asset by way of sale and leaseback where necessary (Refer definitions under Addendum “A” of IVA 1).

- **AASB 136 – Impairment of Assets;**

The main requirement of this standard is to ensure that assets are carried at amounts that are not in excess of their Recoverable Amount. The requirement to test for impairment is the responsibility of the directors of the reporting entity.

The Recoverable Amount of an asset or cash-generating unit is defined as the higher of its Fair Value less costs to sell and its Value In Use.

Value in Use is defined as the present value of future cash flows expected to be derived from the asset or cash-generating unit or, the depreciated replacement cost of the asset (when the future economic benefits of the asset of a not for profit entity are not primarily dependent on the assets

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ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefit).

The standard also requires that where the Recoverable Amount of an asset is less than the assets Carrying Amount the Carrying Amount of the asset is reduced to its Recoverable Amount and the reduction is an Impairment Loss.

The standard also requires the immediate recognition of Impairment Loss as an expense in the Profit and Loss for assets carried at cost or in accordance with the revaluation accounting for assets carried out at the revalued amount.

• AASB 140 – Investment Property;

This standard requires an entity to measure an investment property after recognition at Fair Value or using the Cost Model specified in AASB 116. The standard applies to reporting periods beginning on or after 1 January 2005.

Investment property is defined as “Land or a Building or a Part of a Building or Both” held by the owner (or by the Lessee under a Finance Lease) to earn rentals or for capital appreciation or both rather than for: -

- (a.) Use in the production or supply of Goods and Services or administrative purposes; or
- (b.) Sale in the ordinary course of business.

Owner occupied property is property held (by the owner or by the Lessee under a Finance Lease) for use in the production of supply of goods or services for administrative purposes.

• AASB 3 – Business Combinations

This standard requires business combinations to be accounted for by applying the purchase method. It requires an acquirer to recognise separately, at the acquisition date, the acquiree’s identifiable assets that meet certain recognition criteria, regardless of whether they had been previously recognised by the acquiree.

The standard requires the identifiable assets that satisfy the stipulated recognition criteria to be measured initially by the acquirer at their fair values at the acquisition date, irrespective of the extent of any minority interest.

• AASB 5 – Non Current Assets Held For Sale and Discontinued Operation.

This standard requires that assets that are classified as Held For Sale be measured at the lower of the Carrying Amount and Fair Value less costs to sell.

It also requires that assets that meet the criteria as being classified as Held For Sale be separately presented on the face of the balance sheet.

2.5 Fair Value

Fair Value is defined in AASB 116 as follows:-

“ the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.”

Fair value is considered further in non-mandatory “Australian Guidance” as an accompaniment to AASB 116 set out below.

Fair Value

- G1 The fair value of an asset is the best estimate of the price reasonably obtainable in the market at the reporting date in keeping with the fair value definition. It is the most advantageous price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. The estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, or concessions granted by anyone associated with the sale.
- G2 Underlying the paragraph 6 definition of fair value is a presumption that the entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Similarly, to determine the fair value of an asset, it is assumed that the asset is exchanged after an adequate period of marketing to obtain its most advantageous price. The fair value of an asset is determined by reference to its highest and best use, that is, the use of the asset that is physically possible, legally permissible, financially feasible, and which results in the highest value. Opportunities that are not available to the entity are not taken into account. Where it is the market’s assessment that it is rational to continue to use the asset, the revalued amount shall include estimated entry costs. Where the asset is held for sale AASB 5 Non-current Assets Held for Sale and Discontinued Operations applies.
- G3 Where a quoted market price in an active and liquid market is available for an asset, that price represents the best evidence of the asset’s fair value. When a quoted market

price for the asset in an active and liquid market is not available, the fair value is estimated by reference to the best available market evidence of the price for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. This evidence includes current market prices for assets that are similar in use, type and condition ('similar assets') and the price of the most recent transaction for the same or a similar asset (provided there has not been a significant change in economic circumstances between the transaction date and the reporting date). Current market prices for the same or similar assets can usually be observed for land, non-specialised buildings, used motor vehicles, and some forms of plant and equipment. For land and buildings, these prices can also be derived from observable market evidence (e.g. observable current market rentals) using discounted cash flow analysis.

- G4 In some circumstances the fair value of the asset is not able to be determined from market-based evidence as the market buying price and market selling price of an asset differ materially because the asset usually is bought separately in the new asset market, but if sold separately, could only be sold for its residual value. In other circumstances the fair value of the asset is not able to be determined from market-based evidence as there is no market evidence of the asset's market selling price. These circumstances will usually arise where the transaction price evidence arises in a monopoly context or the asset is specialised and rarely sold, except as part of a continuing business.
- G5 Where the fair value of an item of property, plant and equipment cannot be reliably determined using market-based evidence as outlined in paragraph 33 of AASB 116, the asset's fair value is measured at its market buying price and the best indicator of an asset's market buying price is depreciated replacement cost or an income approach. Depreciated replacement cost is the current replacement cost of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset.

2.6 Depreciated Replacement Cost

IVSC Definitions

Depreciated Replacement Cost. The current cost of reproduction or replacement of an asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

Specialised Property. Property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.

Improvements. Buildings, structures, or modifications to land, or a permanent nature, involving expenditures of labour and capital, and intended to enhance the value or utility of the property. Improvements have differing patterns of use and economic lives.

Adequate Profitability. When an asset has been valued by reference to depreciated replacement cost, adequate profitability is the test that the entity should apply to ensure that it is able to support the depreciated replacement cost conclusion.

Service Potential. The capacity to provide goods and services in accordance with the entity's objectives, whether those objectives are the generation of a net cash inflows or the provision of goods and services of a particular volume and quantity to the beneficiaries thereof. In the public sector, the concept of *service potential* takes the place of the test of *adequate profitability* applied in the private sector.

Modern Equivalent Asset (MEA). An asset similar to an existing asset and having the equivalent productive capacity, which could be built using modern materials, techniques, and design. Replacement cost is the basis used to estimate the cost of constructing a modern equivalent asset.

Impairment Loss. The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. International Accounting Standard 36 (IAS 36), para. 6.

Optimisation. The process by which a least cost replacement option is determined for the remaining service potential of an asset. It is a process of adjustments reducing the replacement cost to reflect that an asset may be technically obsolescent or over-engineered, or the asset may have a greater capacity than that required. Hence

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optimisation minimises, rather than maximises, a resulting valuation where alternative lower cost replacement options are available. In determining the depreciated replacement cost, optimisation is applied for obsolescence and relevant surplus capacity.

2.7 IVSC Guidance

Depreciated replacement cost is used where there is insufficient market data to arrive at Market Value by means of market-based evidence.

AASB 116, Property, Plant and Equipment, paragraph 33, provides that in the absence of market-based evidence an entity may need to estimate the fair value of a specialised asset using an income or a depreciated replacement cost approach.

International Public Sector Accounting Standard (IPSAS) 17, Property, Plant and Equipment, paragraphs 42 and 43, prescribe the use of *depreciated replacement cost for valuing specialised buildings and other man-made structures as well as items of plant and equipment of a specialised nature*.

Property, plant and equipment that is commonly traded in the market should be distinguished from specialised assets.

The classification of an asset as specialised should not automatically lead to the conclusion that a *depreciated replacement cost* valuation must be adopted. Even though an asset may be specialised, it may be possible in some cases to undertake a valuation of a specialised property using the market comparison approach and/or the income capitalisation approach.

In the absence of direct market evidence, *depreciated replacement cost* is regarded as an acceptable method of assessing the value of specialised assets but the methodology must incorporate market observations by the Valuer with regard to land value (for property assets), current cost, and depreciation rates. The methodology is based on the same theoretical transaction between rational informed parties as the Market Value concept.

- In applying the *depreciated replacement cost* methodology, the Valuer should refer to IVGN 8

2.8 Specialised Properties

The conceptual approach to the valuation of specialised assets has not altered in relation

to assets which are not traded in the market place. In the absence of direct market transaction evidence for specialised assets, the use of depreciated replacement cost or income methodologies, is endorsed at paragraph 33 of AASB 116 as follows:-

“If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.”

The depreciated replacement cost approach for financial reporting is considered in GN8, IVSC Standards 2005.

The term *fair value less costs to sell* used in Australian accounting standards is not applicable unless the asset is held for disposal. Market value will still apply in this circumstance to property, plant and equipment, but not as part of a going concern.

2.9 Application

Points that valuers should note are:

- a) In the majority of instances in relation to property, fair value will be equivalent to market value.
- b) For specialised properties the application of the depreciated replacement cost approach or the income approach is an acceptable methodology for valuations for financial reporting purposes provided the value determined is consistent with the fair value definition.
- c) In the absence of direct (market) transaction evidence, when the depreciated replacement cost approach methodology is applied, valuers should consider the elements of depreciation and their application.
- d) Wherever possible, depreciation should be based on market evidence. (See IVSC GN8). Valuers constantly analyse market transactions which indicate a relationship between new cost, depreciation and value. These transactions can be indicative of depreciation for depreciated replacement cost purposes if care is taken to exclude influences such as economic depreciation affecting property sold for a use other than its original purpose-design use.

- e) Where the depreciated replacement cost approach is adopted and the value of the land for an alternative use is equal to or higher than the value of the (total) asset - after allowing for the cost of works to bring the land to a state in which the alternative use can be exploited (e.g. demolition and removal of plant and equipment and its cost of relocation) - then the land value, net of these costs, is the value of the asset.
- f) Consideration should also be given to the potential alternative use value of improvements on the land e.g. a building shell after removal of all plant and equipment. The alternative use value assessment does not necessarily mean that the improvements have no value for the alternative use.
- g) When an asset used in a for-profit enterprise has been valued by reference to the depreciated replacement cost, adequate potential profitability becomes the test (an "impairment" test) applied by the entity to the depreciated replacement cost estimate to determine whether the asset can be carried at that amount.
- h) The depreciated replacement cost approach methodology is expressed as subject to the test of the adequate profitability (or service potential in the case of assets employed in a not-for-profit enterprise) of the assets held by the entity.

2.10 Fair Value Responsibility

The application of Australian Accounting Standards and International Accounting Standards is complex. Valuers of property, plant and equipment assets for financial reporting purposes should be aware of the inter-relationships and complexities.

The application of Market Value concepts by professional valuers will normally be the foundation of an independent assessment of value for financial reporting purposes.

However, ultimately the determination of Fair Value is the responsibility of the reporting entity.

3.0 Categorisation of Assets

3.1 Operational Assets

Operational Assets are categorised as follows:

- Non-Specialised, or
- Specialised

3.2 Degree of Specialisation

Operational Assets may be Non-Specialised or Specialised in whole or part. The valuer assesses the degree of specialisation having regard to the following:

- the use to which the asset is put,
- the degree of special adaptation,
- the location,
- whether that category of asset has a readily definable market; and
- any guidance by the directors and/or technical staff of the entity.

3.3 Non-Specialised Assets

Non-Specialised Assets are those normally traded in an open market where market-based price indicators are available to guide both market participants and market observers. These Non-Specialised Assets can be further categorised as those assets which are common and regularly traded in the marketplace and include offices, warehouses, shops, etc. and those that generate an income or profit by their operation and are traded in the open market and include trading hotels, hospitals and casinos.

3.4 Specialised Assets

Specialised Assets are those not normally traded in any market, except as part of a total enterprise by reason of their specific design, size, location or other factor. These assets include, but are not limited to, oil refineries, power stations, communication towers, notable public buildings, roads and drains, parks and gardens, and can include standard buildings such as offices or warehouses in a market where there is little or no demand for the asset if it is no longer an operational asset.

3.5 Other Considerations

The degree of specialisation will determine the valuation methodology adopted.

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Some assets may possess elements that fall into more than one category, for example multi-purpose or mixed use properties. Each element of the asset should be valued on the designated basis reflecting the degree of specialisation or non-specialisation.

A *Value in Use* determination is entirely the prerogative of the entity.

Where the *Fair Value* of specialised assets is calculated by the *depreciated replacement cost approach* and advised to the entity for inclusion in financial statements, the valuation will be subject to the impairment test. Both *Fair Value* and *Fair Value less costs to sell* are said to be asset specific whilst *Value in Use* is entity specific. In current Australian financial reporting practice, carrying amounts reported at Fair Value are tested for impairment by the Fair Value of the cash generating operation.

The *depreciated replacement cost* of specialised assets and their *Value in Use* are different approaches to value, which may not yield consistent figures. Valuers should be aware that depreciated replacement cost determinations will include items of functional and economic obsolescence as well as physical depreciation. These items are asset specific and will take into account current market conditions for the particular assets at the date of valuation.

consistency with the prior period. The auditor will consider these matters and the valuation itself in the light of the auditors overall knowledge of the entity's business.

The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the valuer. The audit needs to determine that they are not unreasonable, based on the auditors knowledge of the entity's business.

Internal valuers will normally be under instruction to comply with any request from an auditor. While independent valuers may not be under a statutory or contractual obligation to comply with any reasonable request from an auditor, it is in the interests of the entity, its ownership group and the valuer that the valuer should comply as failure to do so may mean that the auditor will not be able to express an unqualified opinion. In such circumstances the approval of the client should be obtained.

The valuer, whether internal or independent, should co-operate reasonably and responsibly if approached by the auditor.

It is of particular importance that any special assumptions and/or limiting conditions be clearly and unequivocally disclosed by the valuer.

4.0 Other Issues

4.1 Liaison with Auditors

Auditors may request a valuer to provide information or explanations related to the valuations and may also seek assurance that valuers have experience in the location and category of the assets being valued.

Auditors may also communicate with valuers to:

- specify items the auditor expects the valuation report to cover
- clarify the valuers relationship with the client; and
- clarify the assumptions and methods to be used by the valuer.

Auditors require assurance that the valuers work constitutes appropriate audit evidence. Issues which are of particular relevance to auditors are the sources of data used, assumptions and methods used and their appropriateness and

AVGN 2 VALUATIONS FOR INSURANCE PURPOSES

This Guidance Note should be used in conjunction with IVS 1 & IVS 3 in particular.

1.0 Introduction

1.1 Purpose

The purpose of this guidance note is to provide information, commentary, advice and recommendations to members undertaking valuations of property, plant and equipment for insurance purposes.

1.2 Status of Guidance Notes

Guidance notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a member. They are an integral part of the Valuation and Property Standards Manual.

1.3 Scope

This guidance note applies to API members undertaking valuations for insurance purposes. PINZ members are referred to a separate guidance note specific to New Zealand (NZVGN 2 – Insurance Valuation Reports). As there are many types of assets and various levels of reporting, the member should decide which matters are applicable and the extent of detail required to ensure that the client is adequately and appropriately informed. This Guidance Note is not intended to outline methods of valuation of any particular type of asset but may comment on matters that should be addressed in reports in respect of certain property types or uses. Where appropriate, methods of valuation are covered in other Guidance Notes.

1.4 International Valuation Standards

This guidance note is intended to be consistent with the publication "International Valuation

Standards 2007" as issued by the International Valuation Standards Committee. However, there may be departures from IVSC Standards to reflect Australian law and practice.

1.5 The Role

In addition to the responsibilities covered in IVS 1, IVS 3, IVA 2 and ANZVGN 1 the Members role (subject to the scope of work agreed with the client) is to advise:

- The replacement/reinstatement and/or indemnity value of the assets for insurance purposes at the date of valuation, in accordance with the requirements of policy wording.
- Factors that can or could impact adversely on the assets in respect of insurance issues. The Member may attempt to quantify the adverse impact or risk or draw the client's attention to the need for re-assessment should these risks eventuate.

2.0 Instructions

2.1 Instructions from Client

All instructions to members to undertake valuations for insurance purposes should be confirmed in writing by the client.

2.2 Policy Issues

Clear instructions need to be obtained from the client confirming the scope of the work, policy conditions under which the assets are insured, and the extent of inclusions under the policy.

3.0 Report Content

3.1 Buildings

In addition to those items covered under IVS 1, IVS 3 and ANZVGN 1, a replacement/reinstatement and/or indemnity insurance valuation report for building and site improvements should include:

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- A replacement/reinstatement with new value and/or indemnity value as at the date required
- The extra necessary costs, if any, to comply with current building and fire regulations.
- The cost of demolition and removal of building debris.
- Cost increases during policy period
- An allowance for cost increases during lead time, ie the period after a major loss when debris is removed, building plans are drafted, and necessary approvals are obtained.
- An allowance for cost increases during rebuild period.
- Estimated limit of liability.
- A statement as to the treatment of GST.
- A statement of specific valuation exclusions such as plant, equipment, tools, furniture and the like.
- A full description of assets.
- Extent of betterment, if any, should the replacement asset be better or more extensive than its condition when new.
- Any change impacting on land value caused by loss of the improvements should be noted.

The loss of rent may be required as a separate request to the insurance valuation

3.2 Plant & Equipment

For plant and equipment assets, report content should clearly state or explain the following.

- The reinstatement/replacement with new value and/or indemnity value as at the date required.
- The foreign exchange rates prevailing at the date of valuation for equipment manufactured overseas.
- The treatment of obsolete assets.
- The treatment of cost inflation.
- The treatment of the cost of money during the replacement process.
- Installation and commissioning costs.
- The treatment of debris removal costs.
- The treatment of GST.
- The extent of betterment, if any.

- Valuation exclusions such as landlord's fixtures and fittings, stocks and materials in trade, and the like.

4.0 Insurance Policies

4.1 Policy Types

There are different types of policies available. The most common are:

1. *Common Householders Policy:*

There are two main types:

- (a) Common policies where the insurer may elect to replace, repair, or indemnify in the event of a loss.
- (b) Replacement with new policies, which sometimes can have age provisions or can be regardless of age.

2. *Industrial Special Risk (ISR Policy)*

The most common policy for commercial/ industrial insurance. This policy addresses many areas in addition to asset insurance.

4.2 Policy Wording

When undertaking an insurance valuation of improvements or plant and equipment, the valuer should seek client instructions. Where instructions are not clear the valuer should seek clarification and in respect to policy wording, a copy of the insurance policy document may need to be obtained together with definitions. The wording thereof may need to be examined to establish the correct basis and methodology for the valuation. Some of the issues to consider when reading a policy document are described below and are taken from a typical policy.

4.3 Situation

The situation is the particular location of the insured assets. It should be defined in a precise way as to where the assets are located. An owner may have many situations covered by the same insurance policy.

4.4 Property Insured

The typical policy document insures all real and personal property of every kind and description, unless specifically excluded, belonging to the insured or for which the insured is responsible or has assumed responsibility to insure.

In addition to the buildings, plant and equipment other assets may include:

- External paving,
- Sheds, carports, etc,
- Lighting,
- Awnings,
- Flagpoles,
- Radio and television masts and antennae,
- Above and below ground tanks,
- Signage,
- Fire services,
- Water and electrical reticulation throughout site,
- Walls, fences and gates.

In some circumstances a property owner may self-insure some assets and these should be identified.

The property insured also extends to all such property in which the insured may acquire an insurable interest during the period of insurance. An insurable interest may result from the completion of an agreement to purchase an asset even though settlement may occur at a future time.

4.5 Typical Policy Indemnity

The typical policy provides that in the event of any physical loss, destruction or damage, which has not been specifically excluded under the policy, happening at the situation to the property insured, the insurer will indemnify the insured in accordance with the applicable basis of settlement.

The insurer will also typically indemnify the insured for the following, provided the liability of the insurer does not increase beyond the limit of liability (refer 4.13).

- Fees associated with the cost of rebuilding such as those applicable to architects, surveyors, consultant engineers, legal and the like.
- Government fees and charges.
- Costs and expenses incurred for the purpose of extinguishing a fire at or in the vicinity of the property insured and threatening to involve such property.
- Costs associated with making the property safe after a loss.

- Costs of replacing locks, keys or safe combinations in appropriate circumstances.
- Costs and expenses necessarily incurred in respect of removal of debris.
- Damage to tools and clothing belonging to Directors and employees of the Insured whilst on the Premises.
- Temporary protection of undamaged property.
- Temporary repairs.
- Property of others for which insured is legally liable.

Modern policy wording, such as the above, has moved away from the concept of providing “blanket” cover for multiple ownerships (many situations) and requires each situation to have adequate cover. That is, each building at each location is required to be insured fully and correctly. This implies that, for the determination of limit of liability proper allowances are made for the above fees and costs on an individual basis.

4.6 Basis of Settlement

The most common insurance policies provide for settlement on a Replacement / Reinstatement basis.

If the insured elects not to replace/reinstate or repair the asset then the insurer may make a payment on the basis of the indemnity value of the asset at the time of the happening of the damage, where indemnity value is, for example:

the cost necessary to replace, repair and/or rebuild the asset insured to a condition and extent substantially equal to but not better or more extensive than its condition and extent at the time that the damage occurred, taking into consideration the age, condition and remaining useful life of the asset.

The insured may elect to insure on an indemnity basis only.

4.7 Interest of Other Parties

Insurable interests of parties such as lessors, financiers, trustees, mortgagees, owners and the like which are specifically noted in the records of the insured may be included in the cover without notification or specification. The nature and extent of such interests should be disclosed by the insured in the event of damage.

The valuer should be aware of other party interests

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and should act in the knowledge that liability for the valuation may extend to those other parties.

4.8 Replacement / Reinstatement

Where this is a basis for settlement then typically, the amount payable is calculated as the cost of reinstatement of the damaged asset insured at the time of its reinstatement, subject to the following provisions and subject to the defined limit of liability in the policy.

Replacement/Reinstatement is typically defined as follows:

- Where property is lost or destroyed: in the case of a building, the rebuilding thereof or in the case of property other than a building, the replacement thereof by similar property in either case in a condition equal to, but not better or more extensive than, its condition where new.
- Where property is damaged: the repair of the damage and the restoration of the damaged portion of the property to a condition substantially the same as, but not better or more extensive, than its condition when new.

The valuer should ensure that the valuation does not give rise to betterment. That is, where the assessed value is based on a more substantial or superior property than that which exists. If betterment is unavoidable, then an offsetting allowance should be made against the assessed value.

4.9 Provisions

Typical provisions are:

- Rebuilding, replacing or repairing must commence as soon as possible after the loss and may be carried out upon any site and in any manner subject to the liability of the insurer not being thereby increased.
- In the case of a partial loss the cost of the damage cannot exceed the total sum insured.
- A claim for a loss may be subject to a co-insurance clause (refer 4.12).
- No payment will be made until a sum equal to the cost of reinstatement has been incurred.

Replacement/Reinstatement not only relates to assets at the situation, but also, for buildings and site improvements, requires the determination of limit of liability to be assessed at the time of

its reinstatement. That is, for the insured to be adequately covered, the valuer should determine all costs associated with reinstatement/replacement of assets assuming a worst case scenario that a loss may occur on the last day of the policy period.

4.10 Extra Cost of Reinstatement

Policies for buildings and site improvements may extend to include the extra cost of reinstatement of damaged property to comply with the requirements of any Act of Parliament or regulation made thereunder or any by-law or regulation of any municipal or other statutory authority.

These would include current building and fire regulations. This extension is typically subject to the following provision:

- The amount of the claim cannot include the cost of complying with a requirement which existed prior to the loss occurring and with which the insured was required to comply.

An insurance company will only insure the assets as they exist, not as they may be replaced. The reason for this is the incidence of a partial loss where repairs are made to the existing structure.

However it may not be possible to determine a reinstatement/replacement value for an existing structure because it no longer complies with current building and fire regulations or other statutory encumbrances.

Insurance companies therefore allow the insured to insure for the extra costs associated with complying with these regulations. Accordingly, the insured may wish to declare a sub-limit in respect to extra costs of reinstatement. The valuer may determine this amount on an elemental basis by aggregating the additional elemental costs required to comply with the regulations.

4.11 Reinstatement Rights

In the event of a total loss and where as a result of the exercise of statutory powers by a regulatory authority, the reinstatement of a building as it existed prior to the loss may be prohibited or restricted. Accordingly, the insurer may pay in addition to any other amount payable on reinstatement of the building the difference between:

- a. the actual cost of reinstatement. ; and,
- b. the cost of reinstatement if it is not prohibited or restricted.

Any payment made for the difference between (a) and (b) above would be made as soon as the difference is ascertained upon completion of the rebuilding works and certified by the architect acting on behalf of the insured in the reinstatement of the building.

4.12 Co-Insurance

A standard clause in a typical policy document relating to this matter may read as follows:

“In the event of damage to property insured hereunder at any Situation caused by any peril hereby insured against, the Insurer shall be liable for no greater proportion of such damage than the amount of the Insured’s declaration of value of such property on the day of the commencement of the Period of Insurance bears to the sum representing eighty five percent (85%) of the actual value of property insured at such Situation on the day of commencement of the Period of Insurance but not exceeding the Limit of Liability expressed in the Schedule.”

For this example, the insured and the insurer agree that they will share the liability of any claim according to the ratio of the declared amount and 85% of the actual value of the property insured. If the declared value is the lower amount then the clause comes into effect.

While 85% is the usual percentage applied to the calculation of the insurer’s liability, other percentages may be adopted.

4.13 Limit of Liability

When assessing sums insured for buildings and site improvements, the limit of liability is the amount representing the maximum liability of the insurer for any one loss or series of losses arising out of the one event at any one situation. That is, the determination by a valuer of the limit of liability should be all embracing including the following:

- The immediate replacement/reinstatement of value of the asset, including an allowance for preliminaries and contingencies.
- Extra cost of reinstatement to comply with current building and fire regulations.
- Cost of removal of debris.
- Professional fees.
- Statutory fees.
- Cost increases incurred in the policy period.

- Cost increases during lead-time during which demolition takes place, building plans are drafted and submitted to council for approval (assuming the loss occurs on the last day of the policy period).
- Cost increases during reconstruction period (assuming the loss occurs on the last day of the policy period).

4.14 Loss Situation

Insurance companies (insurers) employ skilled loss adjusters and forensic scientists when property destruction or damage occurs to adequately protect the insurers from both poorly calculated loss claims and inflated claims.

The insured may also employ its own assessor to make certain all aspects of a claim are considered by the insurer.

5.0 Replacement/Reinstatement Cost for Buildings

In completing a Replacement/Reinstatement cost valuations a valuer should consider the items below and have regard to section 4 above.

5.1 Elemental Costs

For buildings, the determination of the current reinstatement /replacement value may require establishing the elemental cost of construction of the various structural components. Building plans and specifications should be obtained whenever possible to assist in the accuracy of the determination.

Recent constructions of a similar nature assist the valuer to determine the appropriate cost for each part of the construction process. The valuer should consider the evidence available and assess the information in terms of comparability to the subject site and form an opinion as to the appropriate cost to adopt for each particular element of construction.

Alternatively or as a check method the valuer may refer to building cost guides for any variation against indicative ranges. If there were a variation then the valuer would be alerted to establishing reasons for the justification of the valuation adopted.

A further check can be made by having regard to the percentage of each element against total cost and comparing this to industry standards. Again,

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any marked variation would require reasoned, researched explanations.

In certain circumstances it may be appropriate for the valuer to forego this part of the valuation in lieu of establishing an average rate per square metre for the total construction.

Valuations undertaken in non-metropolitan and remote areas would usually reflect regional costs associated with labour and materials. The location factor can be assessed by investigating local construction costs and/or by examining a sample of costs and relating them to known cost centres.

Unless specifically excluded, all property assets are required to be included in the determination of insurable value. These may include:

- Building shells and services,
- Fixtures ,
- Walls,
- Gates,
- Fences,
- Paving,
- Awnings,
- External signs and lighting,
- Flagpoles,
- Radio and television masts and antennae,
- Other structural improvements including sheds, carports, etc,
- Underground tanks,
- Services and connections including supply mains and meters.

5.2 Building Rates

A valuer may provide a client an estimate of insurable value based on rates published in building cost guides, but care should be taken in their application. The estimate will provide a modern equivalent cost and not necessarily the cost to replace the existing structure

Such rates are intended to provide broad estimates. The Member should have regard to variations such as:

- Specific materials used in the building (eg mixture of stone, brick, plasterboard, etc).
- Location factors (i.e. non metropolitan sites).

- Design of building, including soil type, special footings, etc.
- Extra cost of reinstatement to comply with current building and fire regulations.
- Recovery of value for materials in a demolition.
- External dimensions of a building (rates per square metre published by some cost guides relate only to internal building measurements).
- All fees associated with reconstruction including architects, survey and engineering fees.

5.3 Fees and Contingencies

The valuer should assess in each case the extent of involvement of professionals such as architects, surveyors, consultant engineers and the like, and needs to continually research the prevailing level of fees relating thereto, as they can fluctuate considerably between high and low demand periods

5.4 Lead Time

This is the period of time after a loss occurs when remaining improvements are demolished, plans and specifications of the replacement building are drafted and agreed upon, appropriate approvals are sought and obtained from local government authorities and all matters are completed in preparation for rebuilding.

The valuer's assessment of this period should have regard to industry experience and continual research into the time required to complete each of these tasks including process and approval times for local government.

For buildings and site improvements, cost increases during this period need to be calculated and added to the determination of the total sum insured.

For plant and equipment the unpredictability of future cost inflation, especially that caused by foreign exchange fluctuations, generally precludes an allowance to be made under this heading.

5.5 Reconstruction Period

This is the period from the time building approvals have been obtained to completion and hand-over of the new facility.

Cost increases should to be added to the total sum insured but only to the extent that the building is completed in various stages.

The valuer should consider each element of construction to determine what allowance for cost increases should reasonably be made.

As noted above, for plant and equipment the unpredictability of future cost inflation, especially that caused by foreign exchange fluctuations, mostly precludes an allowance to be made under this heading.

5.6 Demolition & Removal of Debris

The amount determined under this heading is calculated by having regard to demolition and removal costs of similar construction in the locality of the situation. The valuer should allow for the amount able to be recovered by the demolition contractor for the building materials.

Further consideration should be given to the presence of known asbestos within a building, difficulty in gaining access to a site, the hazardous nature or otherwise of the debris after a major loss on the basis of total destruction of the site. The valuer should assume that all assets would be destroyed in a loss situation and would require removal prior to reinstatement.

5.7 Limit of Liability

As described in the policy, this is the amount representing the maximum liability of the insurer for any one loss or series of losses arising out of the one event at any one situation. It should therefore encompass the total cost of replacement/reinstatement from the time the policy commences up to the time replacement/reinstatement takes place after a loss.

In the worst case scenario a loss could occur on the last day of the policy period. If this was so, the insured would expect that there is sufficient cover to include all the likely costs not only associated with reconstruction but also in respect to making the property safe and secure, protecting undamaged property and the like.

6.0 INDEMNITY VALUE ASSESSMENT

6.1 Buildings

The indemnity value assessment should take into consideration the age, condition and remaining useful life of the asset. In the case of insurance, useful life is not synonymous with economic life, but rather, physical life. The insured is entitled to

insure the remaining physical life of an asset, even though the economic life may have expired.

Therefore, the determination of indemnity value requires in the first instance, the assessment of replacement/reinstatement value in accordance with the methodology stated above and then an assessment to be made of the likely physical life of the asset and the life expired. The expected physical life of an asset is assessed on the basis that reasonable maintenance is carried out to preserve the existing use.

The valuer should undertake research into the expected life of assets in the location of the valuation and elsewhere as appropriate.

It is common to apply a straight-line method of depreciation when determining indemnity value, which assumes that the remaining service potential of the asset is used up at a constant rate assuming reasonable maintenance. There are however other methods including reducing balance (diminishing value).

6.2 Plant and Equipment

The indemnity value of plant and equipment is an amount equal to the cost of replacing an existing asset with an identical or substantially similar asset of comparable age, in comparable condition and of similar but not better utility together with the cost of transport, installation, commissioning any other directly attributable costs

7.0 HERITAGE ASSETS

The principles of valuing buildings for insurance purposes either on a reinstatement/replacement or indemnity basis apply equally to determining an insurable value for a heritage building.

A building worthy of preservation as determined by relevant heritage authorities is usually because it is a good example of some aspect of heritage. Legislation in most jurisdictions may prevent renovations, modifications, additions and the like by imposing strict requirements and lengthy approval processes. However, in the case where part or the whole of the building has been destroyed along with the element of heritage to be preserved, then that heritage is lost and the owner can only ever replicate it.

The valuer should investigate the relevant legislation to confirm whether or not replication is a compulsory requirement after a loss.

The approach to the insurance valuation is the same as above. The valuer determines the elemental costs in

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rebuilding the structure as it exists allowing for all the “add-ons”, such as extra cost of reinstatement, fees and contingencies, and the like, to comply with policy wording. This method establishes the current cost for repairing or replacing every component of the building in a style and form of construction most closely resembling the original. The valuer should ensure that the engagement of suitable craftsmen, such as those skilled in stone masonry, iron tracery and stained glass, are accurately costed into the calculations.