



GUIDANCE NOTE 463 VALUATION OF SUPERANNUATION FUND ASSETS

APPLICATION

Actuaries who are required under a guidance note or professional standard issued by the Institute to value the assets of a superannuation fund. It may also be used for guidance by actuaries valuing superannuation fund assets in cases where no professional standard applies.

LEGISLATION AND OTHER STANDARDS

The actuary should be familiar with the legislation applicable to the task being performed. For example, the actuary should be familiar with relevant references to valuation of assets contained in the SIS Act, and the Income Tax Assessment Act 1936.

The actuary should also be familiar with relevant Australian accounting standards such as AAS 25, relevant sections of AAS 3 as reproduced in this Guidance Note, AAS 5 and, where relevant, with overseas accounting standards such as SSAP24 and FAS 87.

The actuary should also be familiar with the Auditing Standard AUS 526 issued by the Australian Accounting Research Foundation dealing with the use of an auditor's work by an actuary.

Guidance Note 150, while not directed specifically at Superannuation Funds, addresses the issue of deferred tax liability for unrealised capital gains.

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CLASSIFICATION

Compliance with many of the guidance notes affected by this guidance note is mandatory. Where the actuary is preparing a report or letter in connection with any such mandatory guidance note or professional standard compliance with this guidance note is mandatory. Where valuing assets in accordance with a professional standard, actuaries should treat this guidance note as in effect part of the professional standard.

Where the actuary is preparing a report in connection with a non-mandatory guidance note, compliance with this guidance note is not mandatory. Specific applications at the date of issue of this guidance note include:

- PS 400 Investigation of Defined Benefit Superannuation Funds,
- PS 401 Summaries of Actuarial Reports on the Financial Condition of Defined Benefit Superannuation Funds,
- GN451 Unsegregated Superannuation Liabilities,
- GN 452 Segregated Pension Assets,
- GN 455 Pre 1 July 1988 Funding Credits,
- GN 457 Benefit Certificates for “Deemed” Defined Benefit Funds,
- GN 459 Payments from Superannuation Funds to Employers,
- GN 460 Prudential Reporting to Trustees and the Regulator, and
- GN 461 Funding and Solvency Certificates.

MATERIALITY

The provisions of this guidance note are subject to the standards of materiality applicable to the purpose of the asset valuation.

TERMINOLOGY AND DEFINITIONS

“AAS 3” means the Australian Accounting Standard 3 “Accounting for Income Tax (Tax-effect Accounting)” issued by the Australian Accounting Research Foundation.

“AAS 5” means the Australian Accounting Standard 5 “Materiality in Financial Statements” issued by the Australian Accounting Research Foundation.

“AAS 25” means the Australian Accounting Standard 25 “Financial Reporting by Superannuation Plans” issued by the Australian Accounting Research Foundation.

“Approved Auditor” is an auditor who is an “approved auditor” for the purposes of the SIS Act.

“Dependent Assets” are assets whose value for the purposes of the valuation depends wholly or partly on the ongoing viability and/or profitability of one or more sponsoring employers.

NOTE: Section 71 of the SIS Act defines an in-house asset as (subject to certain exclusions)

“...an asset of the fund that is a loan to, or an investment in, a standard employer-sponsor, or an associate of an employer-sponsor, of the fund...”

“Dependent Assets” for the purposes of this Guidance Note are not synonymous with “in-house assets” under the SIS Act. While “in-house assets” are considered in Section 3(i), this Guidance Note provides the actuary with some discretion in the treatment of assets that are in any way related to an employer sponsor. The appropriate treatment for such assets will depend on the extent to which their value depends on the ongoing viability or profitability of the employer sponsor and the purpose of the valuation of assets.

“Net Market Value of Assets” means, in accordance with AAS 25, the amount which could be expected to be received from the disposal of the assets in an orderly market after deducting costs expected to be incurred in such a disposal.

“Specialist Professional” means any professional who is qualified by education, training or experience to provide advice on the value of one or more of the assets of a superannuation fund. An Approved Auditor is an example of a specialist professional.

“SIS Act” means the Superannuation Industry (Supervision) Act 1993, and the Superannuation Industry (Supervision) Regulations, as amended from time to time.

1. PRINCIPLES FOR VALUATION OF ASSETS

- (i) The purpose of the asset valuation should be considered when selecting a valuation methodology.

Example: When assessing the adequacy of fund benefits to cover retrenchment benefits or benefits on termination of a fund under PS 400, the actuary should consider whether to exclude all or part of any Dependent Assets.

- (ii) The basis for the valuation of assets and liabilities should be consistent to the extent possible.

Example: Inflation rates implicit in the valuation of unlisted property securities should be consistent with those used to value liabilities when calculating a contribution rate under PS 400.

- (iii) Where the actuary is satisfied that the purpose of the asset valuation is not materially different from the purpose of a valuation conducted by the Trustee and certified by an

Approved Auditor, the actuary may rely on values placed on individual assets by the Trustee unless the actuary has reason to believe the values may be inappropriate for the purpose.

If the actuary has reason to believe that such values may not be appropriate the actuary must make further enquiries or consider the adoption of a different valuation of such assets. Where further enquiries are not carried out or the actuary is not satisfied with their outcome, this should be disclosed clearly and the actuary's letter or report appropriately and prominently qualified.

- (iv) Where an audit of the assets of the fund has not been conducted by an Approved Auditor the actuary should be satisfied that the value placed on assets is reasonable and is based on sound data or the actuary's report should be appropriately and prominently qualified.

In assessing an unaudited value of assets, the actuary must consider any available advice from a Specialist Professional. Where the actuary has reason to believe that the advice may not be in accordance with any professional or legal standards or guidelines governing the work of that Specialist Professional, the actuary should make further enquiries. The reasons for any departures from advice given by a Specialist Professional should be explained.

Example: The actuary may seek the advice of a licensed property valuer in determining the realisable value of unlisted property securities.

- (v) The actuary should take due note of any material events that he or she is aware of that occur after the effective date of the valuation of assets and before the date of signing the report or letter, or state that no account has been taken of any such events.

Example: The actuary completes a PS 400 valuation in December, based on fund data (including accounts) as at 1 July. There was a substantial collapse in market valuations of the fund's share investments during October. The actuary should either:

- Make allowances for the collapse in share values in the valuation results; or
- comment on the likely impact of making such an allowance; or
- state that no allowance has been made.

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- (vi) The actuary should avoid undue conservatism unless special circumstances warrant it. Where the actuary has employed a deliberately conservative valuation of assets, the impact and extent of and reasons for such conservatism should be disclosed.

Example: An actuary may choose to be deliberately conservative in the valuation of assets for a mature closed fund, or where a return of surplus to a sponsoring employer is being contemplated.

- (vii) Where the value of assets used for actuarial purposes is materially different from the Net Market Value of Assets the actuary must give clear reasons for the difference in value, including an explanation of the valuation methodology and assumptions used to derive the actuarial value of assets. As AAS 25 specifically excludes any smoothing of assets, where AAS 25 applies the actuary must also state that the valuation of assets differs from the valuation that would or has been placed on the assets by an Approved Auditor in accordance with AAS 25.

- (viii) In valuing assets the actuary may adopt an approximate approach to the value of individual assets that have little or no material impact on the total value of fund assets. This is consistent with the requirements of AAS 25 and AAS 5.

Paragraph 6 of AAS 5 states:

It is not possible to give a definition of "material" that would cover all circumstances. In general, however, an item of information is material if its omission, non-disclosure or misstatement would cause the financial statements to mislead users when making evaluations or decisions. In this context, a necessary assumption is that users will understand the information contained in financial statements and hence may be expected to be influenced by it."

Paragraph 8 of AAS 5 further states:

"In deciding whether an item is material, its nature and amount usually need to be evaluated together. However, in particular circumstances, either the nature or the amount could be the determining factor."

2 TREATMENT OF SPECIFIC ASSETS

In most cases the assets of a superannuation fund at a particular time will comprise a number of items. The treatment of each of these items depends primarily on the purpose of the valuation being prepared by the

actuary. Different functions that may warrant different treatment include assessing immediate solvency, projecting solvency for a Funding and solvency Certificate, certifying an amount of surplus to be returned to a sponsoring employer and recommending a long term contribution rate for funding purposes.

Whatever the purpose of the valuation, when placing a value on the assets of a superannuation fund the actuary should give particular consideration to each of the following items:

(i) Future Income Tax Benefits

The true value of any future income tax benefits depends on:

- the fund continuing to exist and continuing to generate taxable income, and
- future income tax legislation and tax rates remaining unchanged.

Paragraph 19 of AAS 3 (which is relevant for a “going concern”) recognises this and states:

“A future income tax benefit.....shall only be carried forward as an asset where realisation of the benefit can be regarded as being assured beyond any reasonable doubt. Realisation shall depend on:

- (a) the ability of the reporting entity to derive future assessable income of a nature and of sufficient amount to enable the benefit to be realised;*
- (b) the ability of the reporting entity to continue to comply with the conditions for deductibility imposed by the law; and*
- (c) an expectation that legislation will not change in a manner which would adversely affect the reporting entity’s ability to realise the benefit.”*

Paragraph 20 of AAS 3 further states:

“In the case of entities which incur losses, any future income tax benefit shall not be recognised as an asset unless realisation of the benefit is virtually certain...”

Where audited accounts for the fund exist, the actuary is not bound to use the audited provision for future income tax benefits in a valuation of assets. However, before deviating

from any such provision in the audited accounts the actuary should:

- (a) ensure that he or she has a general understanding of the methodology underlying the existing provision,
- (b) ensure that the methodology for deriving a different provision is consistent with the purpose of the letter or report and is also consistent with any corresponding valuation of liabilities, and
- (c) disclose the reason for and the extent of any such deviation.

Example: In examining the solvency on immediate wind-up, an actuary may choose not to include a future income tax benefit that has been included in the audited accounts on the grounds that it cannot be immediately realised. Alternatively, where the actuary is assessing solvency for the purposes of a Funding and Solvency Certificate and is undertaking extended projections of assets and benefits, the actuary may choose to include a future income tax benefit provided that there is future assessable income. Under these circumstances the failure to generate assessable income would be made a 'notifiable event'. Where audited accounts for the fund do not exist, the actuary should disclose the extent of and the reasons for the inclusion of any future income tax benefit.

(ii) *Dependent Assets*

Where the actuary has reason to believe that Dependent Assets may exist about which he or she does not have sufficient information, the actuary should enquire further of the auditor or trustee.

Dependent Assets must be examined closely and consideration given to excluding or discounting their value particularly for the purpose of testing short-term solvency. In any event, the actuary must disclose the extent of such assets and how they have been treated.

(iii) *Unquoted Securities*

Special care should be given to the valuation of securities which are not quoted on an exchange or where regular trading information is not available (such as direct property holdings, some unlisted shares and certain "over-the-counter" derivative contracts).

Paragraph 38 of AAS 25 states:

“...Where a market does not exist for long term monetary assets the calculation of net market value will require the determination of the present value by application of a current, market-determined, risk-adjusted discount rate...”

Further provisions in Paragraph 38 of AAS 25 provide that an auditor may be required to exercise judgement in respect of determining such matters as:

- (a) disposal costs,
- (b) the likely proceeds from disposal of unquoted assets, and
- (c) the appropriate discount factor.

In the absence of audited accounts, an actuary undertaking any valuation of unquoted securities should either:

- base the valuation on his or her best estimate of future cash flows and a separate risk-adjusted rate for each asset so valued, or
- disclose a different method in accordance with Section 1(vii).

Where the actuary is using audited accounts in accordance with Section 1(iii) above he or she may rely on the valuation of unquoted securities contained in the accounts. However, where unquoted securities form a significant part of the total assets, the actuary should at least review the assumptions adopted in the valuation of such assets, where the outcome may be material. The actuary should further disclose in the report or letter that reliance has been placed on audited values of unquoted securities.

Where the actuary is not using accounts audited in accordance with AAS 25 and material unquoted assets exist that have been valued by a third party, the actuary should review the assumptions and methodology used to ensure that they are appropriate. If necessary the assets should be revalued or the report or letter qualified accordingly.

Where the accounts are unaudited and contain unquoted securities it may be necessary for the actuary to seek the advice of a specialist professional before determining a final value of fund assets.

(iv) **Reserves for Tax on Unrealised Capital Gains**

Guidance Note 150 addresses the issues involved and methods available. The actuary should also ensure that the assumptions used in reserving for future tax are consistent with the liability assumptions and the purpose of the valuation.

(v) **Individual Assets that are a Significant Proportion of Total Fund Assets**

The actuary should take particular care in verifying data where an individual asset constitutes a large proportion of total fund assets and audited accounts of the fund are not available.

Where the actuary is undertaking projections of fund assets due weight should be given to the vulnerability of such individual assets to a change in market circumstances.

(vi) **Illiquid Assets**

The actuary should ensure that the valuation of any illiquid assets (such as direct property) is consistent with the purpose of the valuation. In particular, the actuary must avoid undue optimism in the valuation of assets likely to undergo immediate sale, and must likewise avoid undue conservatism in the valuation of assets that are likely to be held for an extended period.

The actuary should comment on the consequences of a significant delay in the sale of an asset, particularly if the asset or this group of assets is a significant proportion of total fund assets.

(vii) **Insurance Policies**

The actuary should give close attention to the valuation of any insurance policies (including traditional “capital guaranteed” policies offered by life insurance companies) to ensure that any such valuation is consistent with the purposes of the valuation.

Paragraph 42 of AAS 25 states:

“...In determining the net market value of insurance policies, reference should be made to the insurer’s assessment of the present value of the insurance policy or, where relevant, the actuarially-determined assessment of the amount recoverable from the insurer. Where, at the reporting date, it is intended to surrender a policy, the policy should be valued at the surrender value...”

In assessing the value to be placed on any insurance policy, the actuary may need to review the terms of the policy and the existence of any penalty on termination of surrender.

Where a policy is in the process of being terminated and a discounted earning rate is being applied to the outstanding balance, the actuary should ensure that the valuation placed on the policy is consistent with:

- (a) the purpose of the letter or report,
- (b) the assumptions adopted for any corresponding valuation of liabilities, and
- (c) the principles outlined in Section 2(iii) above.

(viii) Derivatives

The actuary should consider whether suitable reserves or provisions exist in respect of derivative contracts held by the fund at the valuation date with particular regard to “uncovered” derivative positions and “over-the-counter” derivatives (see Section 2(iii) “Unquoted Securities”).

The actuary should refer to Draft Guidance Note “Investments – Derivative Instruments” for further guidance.

3 SPECIAL CONSIDERATIONS

(i) Assets Which Breach the SIS Act

Assets which may breach the SIS Act include certain “in house” assets, geared investments, loans to members and assets purchased from members. The actuary may also conclude that all or a portion of the assets are inconsistent with the covenants contained in the SIS Act, including these requiring trustees to:

- exercise their duties and powers in the best interests of the beneficiaries,
- keep the assets of the fund separate from any personal assets and from any assets or money of an employer sponsor,
- formulate and implement an investment strategy for the fund having regard to factors such as risk and likely return, diversification, liquidity, and suitability with respect to fund liabilities, and

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- give effect to a strategy for the prudential management of any reserves.

Where such assets exist, the actuary must give consideration to:

- (a) the likely yield of such assets,
- (b) the likelihood of a forced sale or redemption of such assets for compliance purposes,
- (c) the value of such assets on forced sale or redemption, and
- (d) the impact of the fund becoming non-complying.

(ii) Mismatch with Liabilities

Where a significant proportion of the liabilities can be reasonably matched by suitable assets, the actuary should comment on what those suitable assets might be, together with the implications of any difference between the actual asset mix and the matched assets. The actuary should consider the need for a mismatching reserve where there is a significant mismatch between assets and liabilities. The actuary should also explain the potential consequences of such a mismatch and recommend any action considered desirable to reduce the extent of any such mismatching.

(iii) Selling Costs

In valuing assets (particularly where audited accounts are not being relied upon) the actuary should give due consideration to the likely selling costs of all assets. Due weight should be given to the different types of assets held in the fund and the purposes of the valuation being prepared.

4 DISCLOSURE

In addition to the disclosure requirements of any other relevant guidance note or professional standard, the actuary must disclose so much of the following as is relevant within any letter or report that utilises a valuation of assets:

- (i) Where the actuary is relying on audited accounts:
 - the name of the auditor,
 - the effective date of the audit,

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- any audit qualifications, and
 - the Net Market Value of Assets certified in the audit.
- (ii) Where an audit has not been completed, the actuary's own estimate of the Net Market Value of Assets including a description of the method used, who has provided data or opinion that has been relied upon. The actuary should state that such a valuation has not been audited.
- (iii) Where a value other than the Net Market Value of Assets (either estimated or audited) is used:
- the valuation methodology used,
 - the reasons for its use, and
 - the extent of any deviation from the Net Market Value of Assets.
- (iv) A description of any special valuation methodology applied in relation to particular assets, such as:
- illiquid assets,
 - unquoted securities,
 - future income tax benefits,
 - capital gains tax provisions,
 - dependent Assets,
 - assets that have been valued with the assistance of a Specialist Professional including the name and qualifications of the Specialist Professional used
 - insurance policies, and
 - significant individual assets.
- (v) A summarised balance sheet detailing the breakdown of the fund assets.
- (vi) Any special considerations in the valuation of assets such as:
- assets that fail to comply with the SIS Act,
 - mismatching reserves, and
 - any unusual selling costs.

END OF GUIDANCE NOTE