FSC Guidance Note No. 50

Valuation of Scheme Assets and Liabilities

30 November 2022

FINANCIAL SERVICES COUNCIL

FSC Guidance Note No. 50

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Application of this Guidance Note:	This Guidance Note should be applied by the Operator of a Scheme ("Scheme Operator") (whether offered for public subscription or otherwise) in relation to the Scheme.
Main Purpose of this Guidance Note:	The purpose of this Guidance Note in relation to the valuation of the Assets and Liabilities of a Scheme and the determination of the Net Asset Value of a Scheme is: • to specify the principles to be adopted; • to provide guidance in the interpretation and application of those principles; and • to standardise the practices and procedures.
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FSC FINANCIAL SERVICES COUNCIL

FSC Guidance Note No. 50

TABLE OF CONTENTS	Paragraph	Page

FSC Guidance Note No. 50

1 Title

1.1. This Guidance Note may be cited as FSC Guidance Note No. 50 ‘Valuation of Scheme Assets and Liabilities'.

2 Application

2.1 This Guidance Note should be applied by the Operator of a Scheme (“Scheme Operator”) (whether offered for public subscription or otherwise) in relation to the Scheme.

2.2 This Guidance Note should be applied by the Scheme Operator in relation to the valuation of Scheme Assets and Liabilities for:

- the purpose of calculation of the Net Asset Value. The Net Asset Value of a Scheme is then used to determine Scheme Prices in accordance with FSC Guidance Note No. 48 'Scheme Prices' and calculation of crediting rates in accordance with FSC Guidance Note No. 49 ‘Crediting Rates’; and
- the purpose of valuation of non-cash Assets accepted by the Scheme in consideration for an issue of Interests in the Scheme.

This Guidance Note may not apply where the Scheme Operator has obtained an exemption from, or been granted relief under, the applicable legislation in relation to the valuation of Scheme Assets and Liabilities.

2.3 A Scheme may accept non-cash Assets (such as real property) as consideration for an issue of Interests in the Scheme. This Guidance Note applies to the valuation of non-cash Assets introduced to a Scheme in consideration for Interests issued at a price determined in accordance with FSC Guidance Note No. 48 'Scheme Pricing'.

2.4 Where there is a conflict between the recommendations of this Guidance Note, applicable legislation, and the Constituent Documents of a Scheme, the recommendations of this Guidance Note, having regard to the purpose of the Guidance Note, should be modified appropriately so that, as far as practicable, the Scheme Operator complies with the recommendations of this Guidance Note as well as the law.

2.5 This Guidance Note may not cover every situation faced by an FSC Member in the calculation of Scheme Assets and Liabilities and in the determination of the Net Asset Value of a Scheme. Where a situation is not covered, an FSC Member should have regard to the intent of the Guidance Note as described in the Statement of Purpose and the Principles of Valuation of Scheme Assets and Liabilities.

In all circumstances FSC Members should make reference to applicable Australian Accounting Standards and generally accepted accounting principles in determining whether the concepts used in the valuation of Scheme Assets and Liabilities are appropriate, and where different, clearly understand the differences.

Where a Scheme invests in a Scheme managed by an Associate of an FSC Member it is clearly in the best interests of Investors to ensure that appropriate Guidance Notes are applied to the valuation of Scheme Assets and Liabilities.

FSC Members should, where possible, ensure that an Associate complies with the recommendations described in this Guidance Note before recommending investment of Scheme

Assets in a Scheme managed by the Associate and during a period in which the Scheme holds interests in that Scheme.

3 Statement of Purpose and General Principles

3.1 The purpose of this Guidance Note in relation to the valuation of the Assets and Liabilities of a Scheme and the determination of the Net Asset Value of a Scheme is:

- **to specify the principles to be adopted;**
- **to provide guidance in the interpretation and application of those principles; and**
- **to standardise the practices and procedures.**

3.2 The valuation of Scheme Assets and Liabilities is the key determinant of the Net Asset Value of the Scheme, the price of an Interest in the Scheme, and the investment performance of the Scheme.

3.3 The primary purpose of the valuation of Scheme Assets and Liabilities is:

- for Schemes which adopt unit pricing, to determine the prices at which Scheme Interests may be transacted; and
- for schemes which adopt crediting rates for the calculation of crediting rates used in the determination of Interests.

The principles, practices and procedures to be adopted by a Scheme Operator to determine an Investor's interest in a Scheme are described in FSC Guidance Note No. 48 "Scheme Pricing" for unit priced schemes and FSC Guidance Note No. 49 "Crediting Rates" for schemes which adopt crediting rates.

3.4 However, the Valuation of Scheme Assets and Liabilities is also important in that it calculates the Net Asset Value which is commonly used to determine a Scheme Operator's entitlements and other entitlements under the Constituent Documents of the Scheme. The Net Asset Value may also determine the amount of other expenses payable from the Assets of the Scheme (for example, expenses reimbursable to the Scheme Operator).

3.5 It is noted that Scheme Operators may use a different valuation basis for calculating unit prices/crediting rates for the purposes described in paragraph 3.4, and for reporting the value of Scheme Assets and Liabilities in the financial statements of a Scheme. While Scheme unit prices/crediting rates are primarily determined for the purpose of maintaining equity between Scheme Investors and potential and exiting Investors, financial statements of a Scheme are generally produced at a later date, and the impact of new information subsequent to the unit pricing/crediting rate calculation date may necessitate amendments to the value of certain Assets and Liabilities. Also, the method for calculation of entitlements may be dependent on the Constituent Documents of a Scheme, which may not be entirely compatible with the principles and procedures, outlined in this Guidance Note. If a different valuation basis is used for any of the above mentioned purposes, details about the basis, the purpose of and reasons for its use should be documented appropriately.

3.6 The asset valuation process adopted by a Scheme Operator should reflect legislative requirements and requirements under the Scheme's Constituent Documents.

3.7 As the process of valuation of Scheme Assets and Liabilities is significant to Investors and other users of Scheme prices, and may involve the application of subjective judgement, it is appropriate that this Guidance Note provides guidance in the interpretation and application of the principles to be adopted in the valuation of Scheme Assets and Liabilities and in the determination of the Net Asset Value of a Scheme.

3.8 Comparison of the investment performance of a Scheme with that of another Scheme will be enhanced where similar processes of valuation are used. It is clearly desirable that uniformity be adopted within the managed investments, superannuation and life insurance industries in relation to the process of valuing similar Assets and Liabilities.

3.9 An FSC Member should make any necessary variations to its Constituent Documents to ensure compliance with the recommendations of this Guidance Note.

3.10 Consistency across the industry will be facilitated where the Constituent Document of a Scheme is brought into line with the recommendations of this Guidance Note.

4 Application of Materiality

4.1 This Guidance Note applies to the valuation of interests in a Scheme, the calculation of Crediting Rates used in the determination of Interests and the calculation of the Net Asset Value of the Scheme where such application is of material consequence. Failure by a Scheme Operator to adopt or implement a recommendation is material if such failure has the potential to affect:

- Investors' equitable interest in the Scheme's Assets;
- other users of Scheme prices;
- a proper assessment of the investment performance of the Scheme;
- a decision by Investors to allocate scarce resources (investment funds); and
- the calculation of entitlements based on Scheme Assets and Liabilities.

In deciding whether a failure by a Scheme Operator to adopt or implement a recommendation is material, its nature and amount in relation to the Scheme needs to be evaluated. Further information on materiality in relation to errors in unit pricing can be found in Guidance Note No 51 – Errors in Pricing/Crediting Rates when Determining Scheme Interests – Correction and Compensation.

5 Definitions

5.1 In this Guidance Note:

- 'Associate' has the same meaning as in FSC Guidance Note No. 5. 'Industry Terms and Definitions';
- 'Assets' are defined in accordance with applicable Australian Accounting Standards and generally accepted accounting principles;
- 'Constituent Documents' of a Scheme means the material governing rules and documents, including but not limited to the PDS, constitution, Trust Deed or IM, under which the Scheme exists;
- 'Entry Price' means the Scheme price at which an Investor acquires an equitable interest in a Scheme;
- 'Exit Price' means the Scheme price at which an Investor realises an interest in the Scheme;

- 'Gross Assets' means the total Assets of a Scheme before allowances for costs of acquisition or disposal and before deduction of Scheme Liabilities;

- 'Interest' means an undivided portion of the equity of a Scheme;

- 'Investors' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions;

- 'Liabilities' are defined in accordance with applicable Australian Accounting Standards and generally accepted accounting principles. FSC Members should be mindful that where Liabilities are referred to throughout this Guidance Note these include, but are not limited to, tax provisions, expenses, ongoing management fees and performance fees but exclude liabilities relating to unit holder/policy holder balances;

- 'Market Price' means the last sale price immediately prior to the Valuation Point or the current price available at the Valuation Point from a market maker;

- 'FSC Member' refers to a 'Full FSC Member' as defined in FSC's Constitution;

- 'Net Asset Value' of a Scheme means the result obtained by deduction of the value of Liabilities of a Scheme from the value of Gross Assets of the Scheme;

- 'Operator' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';

- 'Prices', in relation to a Scheme, together mean the Entry Price and the Exit Price of that Scheme;

- 'Scheme' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions'; and

- 'Valuation Point' means the point in time at which a cut-off is made to value the Scheme's Assets and Liabilities.

6 Principles of Valuation of Scheme Assets and Liabilities

6.1 The processes of valuing Scheme Assets and Liabilities and calculating the Net Asset Value of the Scheme should meet the following criteria:

- they should be documented and transparent;
- they should be unbiased and equitable;
- they should be applied consistently;
- they should take into account the nature of the assets of the Scheme; and
- they should be reviewed regularly.

This is because these processes form the basis of Scheme Prices, performance and calculation of entitlements.

6.2 Where a Scheme allows for Investors with different classes of interest, the valuation of Scheme Assets and Liabilities should be fair to each class and in accordance with the Scheme's Constituent Documents and the Corporations Act.

7 Application of Principles of Valuation of Scheme Assets and Liabilities: documented and transparent

7.1 FSC Members should have a policy framework in place that documents the Valuation of Scheme Assets and Liabilities. The policy framework should include, at a minimum:

- delegated authorities and accountabilities;
- reporting requirements;
- processes to confirm the completeness of, and compliance with, policies;
- training requirements for policy awareness;
- the alignment of procedures to policies;
- ongoing review of policies and procedures; and
- outsourcing arrangements (where appropriate).

7.2 FSC Members should document and explain the methodologies and assumptions used in valuing Scheme Assets and Liabilities.

8 Application of Principles of Valuation of Scheme Assets and Liabilities: unbiased and equitable

8.1 Where a liquid market exists, the valuation of a Scheme's Assets and Liabilities should be based on the market value of all Assets and Liabilities.

8.1.1 The Gross Assets of a Scheme include the investments of the Scheme, and all other amounts due to and receivable by the Scheme - for example, claims for the repayment of tax levied before the Valuation Point (where applicable) and accrued interest, dividends or rent.

8.1.2 The Liabilities of a Scheme may include amounts payable by the Scheme in relation to investments and (where applicable) in respect of taxation relating to completed accounting periods and the current accounting period (up to the Valuation Point), the amount of the Scheme Operator's other entitlements and any reimbursable expenses accrued (such as any management fees and performance fees unpaid, and any interest accrued on the borrowings of the Scheme) and all other Liabilities payable out of the Gross Assets of the Scheme.

8.2 Where a liquid market exists, the value of Assets and Liabilities used in calculating the Net Asset Value of a Scheme should be determined by reference to market values.

8.2.1 The Market Price should exclude any provision for the costs of acquisition or disposal of a Scheme asset. Costs of acquisition or disposal of a Scheme asset are allowed for, in the transaction cost factor determined in accordance with FSC Guidance Note No 48 'Scheme Pricing' or in determining the value of an Investor's interest in accordance with FSC Guidance Note No. 49 'Crediting Rates'.

8.2.2 Some Scheme Assets and Liabilities (for example money market instruments, mortgage securities and the derivatives associated with these assets) may be valued at other than Market Price. This is particularly relevant to Cash Management Schemes. Should this assumption be inappropriate at a particular Valuation Point, (for example, if the Scheme

Operator expects an Asset to be liquidated) a valuation at Market Price should be obtained and adopted in the valuation of Scheme Assets and Liabilities.

8.3 Where Assets and Liabilities are traded on a properly regulated market (such as a recognised stock exchange) valuations should be based on the Market Price. However, on the rare occasion when:

- **the Market Price is deemed to be unreliable; or**
- **no Market Price is available;**

the valuation of Scheme Assets and Liabilities should be determined in good faith by the Scheme Operator. In such circumstances the Scheme Operator should be satisfied that all relevant factors have been considered in determining the value of the Scheme's Assets and Liabilities and that any exceptions to documented policies and methodologies are clearly documented at the time an alternative valuation is used.

8.3.1 Where Scheme Assets are traded on more than one properly regulated market, the Scheme Operator should value the Asset on the basis of the primary market for the Asset.

8.3.2 Market Price to be used in any valuation should be the most recent (at the Valuation Point) which can be reasonably obtained.

8.3.3 If Assets and Liabilities have been traded infrequently, or if the market in those Assets and Liabilities is thin, the Market Price may be unreliable. In such instances, the Scheme Operator should, in good faith, adopt a valuation where all relevant factors have been considered in determining the value of the Scheme's Assets and Liabilities.

8.4 Where Assets and Liabilities for which there is no properly regulated market are required to be valued a Scheme Operator should, unless it is inappropriate, obtain a valuation from a reputable, independent third party (such as a professional valuer or tax agent), or should otherwise ensure that a valuation is based upon sound and justifiable policies.

8.4.1 A professional valuer should be properly briefed as to the purpose of the valuation of the Scheme Assets and the basis on which the valuation is to be determined (including any legislative requirements, and requirements of the Scheme's Constituent Documents).

8.4.2 The Scheme Operator should provide all the information the valuer may require to complete the valuation.

8.4.3 In certain circumstances where there is no properly regulated market for Assets and Liabilities, it may be neither appropriate nor necessary for particular Assets or Liabilities to be valued by a third party. Examples of such Assets and Liabilities are interests in other Schemes managed by the Scheme Operator or by another Scheme Operator, outstanding settlements, and provision for tax, performance fees, and Scheme Operator's fees payable. For these Assets and Liabilities the respective valuations should be determined by the Scheme Operator based upon sound and justifiable policies which have been clearly documented. Such policies should seek to achieve equity between Investors, and should be regularly reviewed.

8.4.4 Similarly, the value of realised and unrealised tax losses and the like should be determined so as to favour neither a seller nor a buyer of Scheme Interests.

8.4.5 The value of such losses is dependent on future events including the amount of taxable income or gains generated by any increase or decrease in the size of the Scheme and the extent to which future capital gains may be entitled to the discount allowed for Assets held for more than 12 months.

8.4.6 Given these uncertainties a valuation process is likely to conclude that there is a range of acceptable values rather than a single number. Nevertheless unit pricing and crediting rates require the use of a single number. The Scheme Operator should choose the number within that range of values that in its judgment has the least bias in favour of either a seller or buyer of Scheme Interests.

8.4.7 The method of calculation of unit prices and crediting rates when transactions take place in Schemes which are substantially invested in infrequently valued assets is referred to in Guidance Note No. 26 'Asset Valuation and Unit Pricing for Infrequently Valued Assets'.

8.5 The valuation of the Assets and Liabilities of a Scheme should be objective and not subject to undue influence by the Scheme Operator (or associate) and should be independently verifiable.

8.5.1 The valuations adopted by a Scheme Operator in calculating the Net Asset Value of a Scheme should be determined using Market Prices obtained from a reliable independent source.

8.5.2 A number of sources of Market Prices are currently available. A Scheme Operator should ensure that the basis on which Market Prices are supplied is in compliance with the applicable legislation and the Constituent Documents.

8.5.3 Where a Market Price obtained from an independent source is amended by the Scheme Operator for the purpose of valuation (for example, where the Market Price supplied is based on an insignificant or non-arm's length transaction), or where no Market Price is available (for example, a share price is suspended), a Scheme Operator should ensure that the price adopted in the valuation is determined in good faith, is documented at the time of amendment and is in accordance with applicable Australian accounting standards.

8.6 Where, at a Valuation Point, the valuation of Scheme Assets and Liabilities cannot be determined, and to process transactions in an interest in the Scheme has the potential to prejudice Investors, the Scheme Operator should suspend such transactions until the value of the Scheme's Assets and Liabilities can be determined.

8.6.1 A valuation may not be able to be determined for a variety of reasons - for example, where there is a disruption to the information flow necessary to establish the Assets and Liabilities of the Scheme; where markets on which Scheme Assets are traded are closed or restricted and Market Prices cannot be established; where valuations cannot in good faith be estimated by the Scheme Operator (for example, where significant Assets should be disposed of quickly to meet the liquidity requirement of the Scheme).

8.6.2 If the valuation of a Scheme cannot be reliably determined, a transaction in interests of the Scheme should not be processed.

FSC Guidance Note No. 50

9 Application of Principles of Valuation of Scheme Assets and Liabilities: applied consistently

9.1 The valuation should include all of the Assets and Liabilities of a Scheme at the Valuation Point.

9.1.1 Completeness is essential if fairness and accuracy is to be achieved in the valuation of Scheme Assets and Liabilities and determining an Investor's interest in a Scheme. This may include each Valuation Point the Scheme Operator should ensure that all the Assets and Liabilities of a Scheme are properly recognised in accordance with applicable Australian Accounting Standards (where these are applicable for Scheme Pricing or crediting rate purposes) and generally accepted accounting principles.

9.1.2 It is not appropriate to include an amount within the Assets and Liabilities of the Scheme that is used to smooth the effect of an error or more up to date information.

9.1.3 Income receivable by a Scheme up to the Valuation Point should be included in Scheme Assets on a basis consistent with the valuation of Scheme Assets. For example, investment income from shares should be recognised as receivable when securities are marked 'ex-dividend'.

9.2 The Net Asset Value of a Scheme at the Valuation Point should be calculated by deducting from the value of a Scheme's Gross Assets the value of the Liabilities of the Scheme.

9.3 Scheme Assets and Liabilities should be valued assuming a "going concern" basis of the Scheme, unless this assumption is inappropriate.

9.3.1 A "going concern" basis for the Scheme assumes that the Scheme will continue to operate indefinitely. As such, Scheme Assets and Liabilities should be valued at market value, which ignores the impact on that valuation should the Assets or Liabilities actually be acquired or realised.

9.3.2 An example of where a "going concern" basis may not be appropriate is where a Scheme is in the process of being wound up.

9.3.3 The Market Price of an asset applied in the valuation of Scheme Assets need not necessarily reflect the liquidation value of the asset. For example, where the Scheme's holding of shares greatly exceeds the volume recently traded at the Market Price it is likely that the amount obtainable for the total holding would, should that holding be sold, be significantly different to the Market Price. Consequently, the valuation of Scheme Assets does not necessarily reflect the liquidity of a Scheme's Assets.

9.4 Where the Market Price (or other valuation) of an Asset or a Liability of a Scheme is denominated in a currency of another country, the exchange rate to be used in converting the valuation to the base currency should be determined at the Valuation Point on the basis of either the last exchange rate at which a transaction in that currency took place or at the WM Reuters 4pm London Exchange Rates. The basis selected to be used should be consistently applied over time.

9.4.1 Exchange rates should be obtained from the same source wherever possible.

9.5 Scheme Assets and Liabilities should be valued at least as frequently as Interests in the Scheme may be traded, except where the practicalities of valuation are such that it is, in the

opinion of the Scheme Operator, in the best interests of Investors to initiate less frequent valuations.

9.5.1 The minimum frequency at which a valuation of Scheme Assets and Liabilities is made may be laid down in the legislation applicable to the Scheme or in the Constituent Documents. Scheme Operators may decide that valuations of Scheme Assets and Liabilities should be made more frequently than the prescribed minimum (including intra-day pricing/crediting rates where the systems capability of the Scheme Operator allows) where it is in the best interests of Investors.

9.5.2 Further guidance on valuation of infrequently valued assets is contained in Guidance Note No. 26 'Asset Valuation and Unit Pricing/Crediting Rates for Infrequently Valued Assets'.

9.6 Where the formal valuation of certain Scheme Assets and Liabilities is at extended, infrequent intervals (for example, where valuation occurs less frequently than Scheme prices or crediting rates are struck), valuation policies should be developed which limit the occurrence of sudden significant increases or decreases in Net Asset Value which do not reflect a true sudden increase or decrease in underlying value of Assets and Liabilities.

9.6.1 These policies should include the staggering of formal valuations of Assets and Liabilities within the Scheme during the intervening period. Where appropriate, consideration should be given to reflecting estimated movements or general market movements between formal valuations.

9.6.2 Some Scheme Assets and Liabilities by their nature (and partly as a result of the costs of obtaining a valuation) are subject to formal valuation at infrequent intervals (e.g. real property, infrastructure, private equity). Such Assets and Liabilities normally are identified as trading in a low volume, semi-liquid market or could be an interest in Schemes where valuation occurs less frequently than Scheme prices are struck.

9.6.3 Policies for limiting inappropriate sudden significant increases or decreases in Net Asset Value during the intervening period between formally valuations should include:

- where there are two or more such Assets or Liabilities with long periods between formal valuations, each is formally valued at predetermined, regular intervals, and the valuation of each is staggered evenly across the year to avoid concentration of the impact of changes to Net Asset Value to a particular point in time; and
- where the Scheme Operator believes that there has been a significant movement in the true underlying value of an Asset or Liability between formal valuations, the Scheme Operator should consider reflecting this movement in the valuation used for unit pricing or crediting rate purposes. It is preferable that a significant movement trigger a formal valuation to take place, rather than the use of estimated value.

9.7 The value of these Assets and Liabilities should be determined at least annually as a minimum.

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