

FSC Standard No. 9



Valuation of Scheme Assets and Liabilities

October 2006

Main features of this Standard are:

- Specification of the principles to be adopted in the Valuation of Assets and Liabilities of a Scheme;
- Provision of guidance in the interpretation and application of those principles; and
- To standardise the practices and procedures relating to the valuation of the Assets and Liabilities of a Scheme and the determination of the Net Asset Value of a Scheme.

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- 1 Title
- 1.1 This Standard may be cited as FSC Standard No. 9 'Valuation of Scheme Assets and Liabilities'.
- 2 Standards and Commentary
- 2.1 The requirements set out in this Standard are shown in bold print. Commentary is shown in normal print immediately after the requirement to which it relates, as an aid to interpreting the application of the requirements.
- 3 Date of Issue
- 3.1 Originally issued 19 July 1999; updated 22 June 2001, February 2004 and October 2006.
- 4 Effective Date
- 4.1 This Standard must be applied in relation to the valuation of Assets and Liabilities of a Scheme made on or after 1 July 2007. Earlier application of this Standard is permitted and encouraged.
- 5 Application
- 5.1 This Standard must be applied by the Operator of a Scheme ("Scheme Operator") (whether offered for public subscription or otherwise) in relation to that Scheme.
- 5.2 This Standard must 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 Standard No. 8 'Scheme Pricing'; and
 - the purpose of valuation of non-cash Assets accepted by the Scheme in consideration for an issue of interests in the Scheme.
- This Standard 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.
- 5.2.1 A Scheme may accept non-cash Assets (such as real property) as consideration for an issue of interests in the Scheme. This Standard 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 Standard No. 8 'Scheme Pricing'.
- 5.3 Where there is a conflict between the requirements of this Standard, applicable legislation, and the Constituent Documents of a Scheme, the requirements of this Standard should, having regard to the purpose of the Standard, be modified appropriately so that, as far as practicable, the Scheme Operator complies with the requirements of this Standard. Any Scheme created on or after the Effective Date must comply with this Standard unless

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such compliance would conflict with applicable legislation, or the FSC member's interpretation of that legislation.

- 5.4** This Standard may not cover every situation faced by an FSC Member in the valuation 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 must have regard to the intent of the Standard as described in the Statement of Purpose and the Principles of Valuation of Scheme Assets and Liabilities.

In all circumstances FSC Members must 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.

- 5.4.1** 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 standards are applied to the valuation of Scheme Assets and Liabilities.
- 5.4.2** FSC Members must, where possible, ensure that an Associate complies with the requirements described in this Standard 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.

6 Statement of Purpose

- 6.1** The purpose of this Standard 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.

This Standard has been designed with reference to the Joint ASIC and APRA Unit Pricing Guide to Good Practice.

- 6.1.1** 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.
- 6.1.2** The primary purpose of the valuation of Scheme Assets and Liabilities is to determine the prices at which Scheme interests may be transacted. The principles, practices and procedures to be adopted by a Scheme Operator to ascertain the price of an interest in a Scheme are described in FSC Standard No. 8 'Scheme Pricing'.
- 6.1.3** However, the Valuation of Scheme Assets and Liabilities is also important in that it determines the Net Asset Value which is commonly used to determine a Scheme Operator's entitlements and other entitlements under the Constituent Documents of

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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).

- 6.1.4 While it is generally expected that Scheme Operators use the same valuation basis for pricing Scheme interests, for the purposes described in paragraph 6.1.3, and for reporting the value of Scheme Assets and Liabilities in the financial statements of a Scheme, there need be no requirement to do so. While Scheme prices 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 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 Standard. 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 must be documented appropriately.
- 6.1.5 The asset valuation process adopted by a Scheme Operator should reflect legislative requirements and requirements under the Scheme's Constituent Documents.
- 6.1.6 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 Standard 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.
- 6.1.7 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.
- 6.2 Where an FSC Member is, in relation to a Scheme, able to vary the Constituent Document of a Scheme without material additional cost to Investors or Scheme providers, the FSC Member must incorporate within the Constituent Document all the changes necessary to ensure compliance with the requirements of this Standard.**
- 6.2.1 The movement within the industry towards Valuation of Scheme Assets and Liabilities uniformity will be accelerated where the Constituent Document of a Scheme is brought into line with the requirements of this Standard.

7 Application of Materiality

- 7.1 This Standard applies to the valuation of interests in a Scheme and the determination 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 requirement is material if such failure has the potential to affect:**

- Investors equitable interest in the Scheme's Assets;

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- 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 requirement 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 FSC Standard No. 17 – Incorrect Pricing of Scheme Units.

8 Definitions

8.1 In this Standard:

- '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 rules and regulations 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 must be mindful that where Liabilities are referred to throughout this Standard 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;

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- **'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 a 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.

9 Principles of Valuation of Scheme Assets and Liabilities

9.1 The processes of valuing Scheme Assets and Liabilities and determining the Net Asset Value of the Scheme must meet the following criteria:

- they must be documented and transparent;
- they must be unbiased and equitable;
- they must be applied consistently; and
- they must be reviewed regularly.

9.1.1 The valuation of Scheme Assets and Liabilities must be documented, unbiased and applied consistently as it forms the basis of Scheme Prices, performance and calculation of entitlements.

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

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

10.1 FSC Members must have a policy framework in place that documents the Valuation of Scheme Assets and Liabilities. The policy framework must 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;**

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- Ongoing review of policies and procedures; and
 - Outsourcing arrangements (where appropriate).
- 10.2 FSC Members must document and explain the methodologies and assumptions used in valuing Scheme Assets and Liabilities.**
- 11 Application of Principles of Valuation of Scheme Assets and Liabilities: unbiased and equitable**
- 11.1 The valuation of a Scheme's Assets and Liabilities must be based on the market value of all Assets and Liabilities.**
- 11.1.1 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.
- 11.1.2 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 i.e. 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.
- 11.2 The value of Assets and Liabilities used in determining the Net Asset Value of a Scheme must be determined by reference to market values.**
- 11.2.1 The Market Price must 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 Standard No. 8 'Scheme Pricing'.
- 11.2.2 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 must be obtained and adopted in the valuation of Scheme Assets and Liabilities.
- 11.3 Where Assets and Liabilities are traded on a properly regulated market (such as a recognised stock exchange) valuations must 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 must be determined in good faith by the Scheme Operator. In such circumstances the Scheme Operator must be satisfied that all relevant factors have been considered in determining**

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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.

- 11.3.1 Where Scheme Assets are traded on more than one properly regulated market, the Scheme Operator must value the asset on the basis of the primary market for the asset.
- 11.3.2 Market Price to be used in any valuation must be the most recent (at the Valuation Point) which can be reasonably obtained.
- 11.3.3 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 must, in good faith, adopt a valuation where all relevant factors have been considered in determining the value of the Scheme's Assets and Liabilities.
- 11.4 Where Assets and Liabilities for which there is no properly regulated market are required to be valued, a Scheme Operator must, unless it is inappropriate, obtain a valuation from a reputable, independent third party (such as a professional valuer or tax agent), or the valuation must be based upon sound and justifiable policies.**
- 11.4.1 A professional valuer must 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 and/or Product Disclosure Statement or equivalent document).
- 11.4.2 The Scheme Operator must provide all the information the valuer may require to complete the valuation.
- 11.4.3 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, provision for tax, performance fees, and trustee and Scheme Operator's fees payable. For these Assets and Liabilities the respective valuations must be determined by the Scheme Operator based upon sound and justifiable policies which have been clearly documented. Such policies must seek to achieve equity between investors, and must be regularly reviewed.
- 11.4.4 Similarly, the value of realised and unrealised tax losses and the like must be determined so as to favour neither a seller nor a buyer of Scheme interests.
- 11.4.5 The value of such losses is dependent on future events including the amount of taxable income or gains generated by the fund, any increase or decrease in the size of the fund and the extent to which future capital gains may be entitled to the discount allowed for assets held for more than 12 months.
- 11.4.6 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 requires the use of a single number. The Scheme Operator must choose

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the number within that range of values that in their judgment has the least bias in favour of either a seller or buyer of Scheme interests.

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

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

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

11.5.3 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-arms length transaction), or where no Market Price is available (for example, a share price is suspended), a Scheme Operator must 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.

11.6 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 must suspend such transactions until the value of the Scheme's Assets and Liabilities can be determined.

11.6.1 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 must be disposed of quickly to meet the liquidity requirement of the Scheme).

11.6.2 If the valuation of a Scheme cannot be determined, a transaction in interests of the Scheme must not be processed.

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

12.1 The valuation must include all of the Assets and Liabilities of a Scheme at the Valuation Point.

12.1.1 At each Valuation Point the Scheme Operator must ensure that all the Assets and Liabilities of a Scheme are properly recognised and accounted for in accordance with applicable Australian Accounting Standards (where these are applicable for Scheme Pricing purposes) and generally accepted accounting principles. Completeness is essential if fairness and accuracy is to be achieved in the valuation of Scheme Assets and Liabilities and in the pricing of an interest in a Scheme.

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- 12.1.2 It is generally 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.
- 12.1.3 Income receivable by a Scheme up to the Valuation Point must be included in Scheme Assets on a basis consistent with the valuation of Scheme Assets. For example, investment income from shares must be recognised as receivable when securities are marked 'ex-dividend'.
- 12.2 The Net Asset Value of a Scheme at the Valuation Point must be calculated by deducting from the value of a Scheme's Gross Assets the value of the Liabilities of the Scheme.**
- 12.3 Scheme Assets and Liabilities must be valued assuming a “going concern” basis of the Scheme, unless this assumption is clearly inappropriate.**
- 12.3.1 A “going concern” basis for the Scheme assumes that the Scheme will continue to operate indefinitely. As such, Scheme Assets and Liabilities must be valued at market value, which ignores the impact on that valuation should the Assets or Liabilities actually be acquired or realised.
- 12.3.2 An example of where a “going concern” basis may not be appropriate is where a Scheme is in the process of being wound up.
- 12.3.3 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.
- 12.4 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 must 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 must be consistently applied over time.**
- 12.4.1 Exchange rates must be obtained from the same source wherever possible.
- 12.5 Scheme Assets and Liabilities must 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.**
- 12.5.1 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 where the systems capability of the Scheme Operator allows) where it is in the best interests of Investors.

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- 12.6 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 are struck), valuation policies must 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.**
- 12.6.1 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.
- 12.6.2 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. The value of these Assets and Liabilities must be determined at least annually as a minimum.
- 12.6.3 Policies for limiting inappropriate sudden significant increases or decreases in Net Asset Value during the intervening period between formal valuations should include:
- where there are two or more such Assets or Liabilities with long periods between formal valuations, each Asset or Liability is formally valued at predetermined, regular intervals, and formal valuation of each asset 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 purposes (e.g. by using an estimated movement or general market movement).