Valuations & SMSF Checklist for Year End Reporting

SuperGuardian

As 30 June approaches there are a number of key issues to be reminded of. This guide will provide an overview and link to a number of those key issues and will take an in depth look at valuation requirements.

Year end reporting

There are a number of key considerations that must be front of mind for your clients:

Contributions:

- Ensure all contributions are received (banked) by 30 June to be eligible for deductibility in 2020/21 financial year.
- Have your clients maximised their concessional contributions cap including carry forward or the use of deferred allocation? View fact sheet here on carry forward contributions. View fact sheet here on deferred allocations.
- Have your clients made all their non-concessional contributions including bring forward? View fact sheet here
- Are your clients eligible for the Government Co-contribution?
- Are your clients eligible for the Spouse contribution tax offset? View fact sheet here
- Do your clients qualify for the work test? or are they eligible for the work test exemption? View fact sheet here

Pensions:

- Have your clients reached preservation age? Can they benefit from starting a transition to retirement income stream (TRIS) or an account based pension?
- Have your clients met their minimum obligations? and have they paid more than the minimum? If so, view fact sheet here

Asset valuation

It is a legal requirement that all SMSFs record and report all assets at market value. Failure to report assets at market value or misrepresenting the value of assets can have compliance consequences for SMSF trustees.

What does market value mean to an SMSF?

The term market value is used throughout the Superannuation Industry (Supervision) Act 1993 (SISA) and the accompanying Regulations, and in many cases the reference is specific to SMSFs. Importantly, the Regulations make it an operating standard that end of year financial statements must be prepared using **market value**, meaning funds that don't comply can be reported by their auditor.

Subsection 10(1) of SISA defines market value as follows:

> **"Market value"**, in relation to an asset, means the amount that a willing buyer of the asset could reasonably be expected to pay to acquire the asset from a willing seller if the following assumptions were made:
>
> (a) that the buyer and the seller dealt with each other at arm's length in relation to the sale;
>
> (b) that the sale occurred after proper marketing of the asset;
>
> (c) that the buyer and the seller acted knowledgeably and prudentially in relation to the sale.

Using market value means an SMSF can provide an accurate representation of the fund's value and importantly each member's interest in the fund. This ensures that financial reports are meaningful and can be relied upon for decision making, including receipt of contributions and calculations of pensions.

This document provides an overview of the valuation requirements for SMSFs relevant for year-end purposes, plus additional documentation trustees should also provide as part of the annual audit process.

As noted in the definition above, there is a reference to the term "arm's length". SMSFs are required to make and maintain all investments on an arm's length basis, particularly given many SMSF transactions are conducted with related parties.

What does arm's length mean to an SMSF?

According to the ATO, arm's length is where *"a prudent person, acting with due regard to his or her own commercial interests, would have agreed to the terms".*

As such, investments must be made and dealt with by an SMSF on a commercial basis in all circumstances and when dealing with all parties, related or otherwise. The concepts of arm's length and market value are important to ensure a fund satisfies its compliance requirements but also ensure a fund avoids a situation where non-arm's length income (NALI) may arise. NALI is taxed at the highest marginal tax rate, clearly a disincentive for the otherwise concessionally taxed superannuation environment.

Who conducts a valuation?

The ATO have indicated that the process of determining a valuation is generally of more importance than who conducted the valuation in assessing its validity. The key basis is that there must be objective and supportable data. According to the ATO, a valuation can be conducted by one of the following:

- Registered valuer
- Professional valuation service provider
- Member of a recognised professional valuation body
- Person without formal valuation qualifications but with experience or knowledge in a specific area

A qualified and independent valuer is only required in certain situations, but they must be used where collectable and personal use assets are disposed of to a related party. Additional situations where it may be appropriate to obtain an independent valuation include where the asset represents a significant proportion of the fund's value and/or the nature of the valuation is expected to be complex.

What does a trustee need to consider?

As part of the annual SMSF audit a trustee may need to provide an updated valuation, for review, including evidence or documentation of the valuation method used. The valuation needs to be based on **objective and supportable data**, using a fair and reasonable process. According to the ATO, for a fair and reasonable process to be followed, the following must be demonstrated in undertaking a valuation:

- Takes into account all relevant factors and considerations likely to affect the value of the asset
- Has been undertaken in good faith
- Uses both a rational and reasoned process
- Capable of explanation to a third party

The following table summarises the key valuation requirements that are or may be relatable to 30 June each financial year, again reiterating that valuations must be based on **objective and supportable data**:

Valuations	Requirements
Preparing the SMSF Financial Statements	Assets must be valued at market value to satisfy the fund's compliance obligations.
Testing whether the market value of in-house assets exceed 5% of the total assets held by the fund	The value of a fund's total assets needs to be determined on 30 June of any financial year that in-house assets are held. If the value of in-house assets exceeds 5% of total fund assets the trustees must prepare a written plan to dispose of in-house assets to below 5% by the following year.*
Determining the market value of assets that support account based pensions	The market value of the various account based pension account balances are required on an annual basis, as at 1 July of the financial year in which the pension is paid, to allow accurate income calculations to be performed in accordance with the appropriate pension factors.
Determining the market value of assets that support a member's retirement phase and accumulation accounts for purposes of calculating their total super balance	The value of these accounts needs to be determined on 30 June each financial year as this is when the total super balance is calculated. The total superannuation balance dictates an individual's eligibility to certain contribution rules and a fund's capacity to segregate assets, amongst other things.

** Clients should be made aware that relief was provided where a fund's in-house assets exceeded 5% for 2018/19, 2019/20 due to COVID-19.. This relief does not extend to 2020/21.*

How do the valuation requirements affect the different asset classes?

Cash accounts, listed securities, widely held unit trusts/managed funds and cryptocurrencies all have values readily available to use for reporting purposes at 30 June each financial year. Real property, unlisted shares/units; collectables and personal use assets and in-house assets are classes where care must be taken to ensure that a fair and reasonable valuation is used to ensure accurate and meaningful financial statements each financial year.

NOTE: For the purposes of cryptocurrencies the ATO will accept the 30 June closing value published on the website of a cryptocurrency exchange that reports on historical cryptocurrency values.

Real property

According to the ATO's guidelines on valuations, an external valuation of real property is not required each financial year. Most SMSF auditors will request an updated external valuation be performed every three (3) years unless the trustees expect the previous valuation to be materially inaccurate.

If you expect the value has significantly changed since the last valuation due to changing market conditions or other factors, then it would be considered necessary to arrange a new valuation. Examples of significant events that would affect the value of real property include:

- Natural disasters
- Macro-economic events
- Market volatility
- Changes to the character of the asset (renovations etc)

The following factors should be taken into consideration when determining the value of real property:

- The value of similar properties
- The amount paid for the property in an arm's length transaction
- Independent appraisal
- Whether there have been any improvements undertaken since the last valuation

For commercial properties, net income yields are also an important consideration in determining real property value. As a rule council rates notices are not sufficient for property valuations unless supported by documentation above.

Valuations prepared by suitably qualified and independent valuers are less likely to be questioned by auditors and the ATO. However, for financial reporting purposes, the valuation can be undertaken by anyone as long as it's based on objective and supportable data. Therefore, as stated earlier, it must be capable of explanation to a third party.

Additional property information

On an annual basis, the trustees need to be able to provide the following to assist in the audit process and validating property valuations:

- Current market valuation (no more than 3 years old – subject to significant event exceptions)
- Current title search (every 3 years – to satisfy requirements that the asset continues to be held in the correct manner)
- Insurance documentation where appropriate
- Signed property declaration minute/resolution – This document is essentially an annual declaration that the SMSF is the legal owner of the property and states the valuation and justification for that valuation.
- Current lease agreement
- An independent rental assessment is preferred if property is leased to a related party to ensure arm's length dealings (this can be provided every 3 years with the valuation)

To assist trustees in meeting their obligations in valuing the property held within their funds each financial year, SuperGuardian provide a resolution template that can be used to record the market value and the reasons for the value given.

Unlisted investments

Unlisted investments can include shares in private companies, shares in unlisted public companies, units in private unit trusts and units in unlisted widely held unit trusts. For these types of investments there are generally not readily available market prices that can easily be used for financial reporting valuation purposes.

The value of the underlying investments of the entity and the asset value at acquisition are important factors in determining the valuation to use for financial reporting purposes. Where a valuation may be complex an external valuation may be required.

Cost price and net tangible assets (NTA) which are readily available are generally not sufficient valuation methodologies for companies or trusts. For example, NTA cannot be relied upon where a private company or trust prepares special purpose financial statements and assets are shown at cost price or their written down value.

Unlisted public and private companies

To satisfy valuation requirements it may be helpful to consider the following:

- Share price of any share issues or sales within the last 12 months
- Correspondence from the company's CFO with the share price and explanation
- Valuation of company assets and liabilities with evidence and calculations to support
- NTA of company where market or fair value is used in reporting
- Cost price of shares for the first year acquired

On an annual basis, the trustees need to be able to provide the following:

- Signed company financial statements
- Dividend statements
- Current market value of shares
- If a related company with a controlling interest – copies of bank statements and loan statements may be required for significant accounts and any title searches where relevant

Private unit trusts

To satisfy valuation requirements it may be helpful to consider the following:

- Unit price of any unit issues or sales with the last 12 months
- Valuation of unit trust assets and liabilities with evidence and calculations to support
- NTA of trust where market or fair value is used in reporting
- Cost price of units for the first year acquired

On an annual basis, the trustees need to be able to provide the following:

- Signed unit trust financial statements
- Current market value of units
- If a related trust with a controlling interest – copies of bank statements and loan statements may be required for significant accounts and any title searches where relevant

Collectables and personal use assets

Collectables and personal use assets are investments in the following:

Artwork*	Rare folios, manuscripts or books
Jewellery	Memorabilia
Antiques	Wine and spirits
Artefacts	Motor vehicles, motorcycles & recreational boats
Coins, medallions and bank notes**	Sporting club and social club memberships
Postage stamps and first day covers	

*(*Includes paintings, sculptures, drawings, engravings, photographs)*
*(**Note coins and bank notes are collectables where their value exceeds their face value; bullion coins are collectables where their value exceeds their face value and they trade at a price above the spot price of their metal content)*

Whilst these investments are allowed it is important to note that they must be held for genuine retirement purposes and the sole purpose test must be considered. Trustees cannot get any present day benefit from these assets. They cannot be used by or leased to a related party; and they cannot be stored in the private residence of a related party. These assets also have specific requirements regarding insurance as they must be insured in the super fund name within 7 days of acquisition.

For financial reporting purposes, the trustees should be able to follow the general valuation principles to come up with a fair and reasonable valuation or arrange for an external independent valuation to take place. For investments without a ready market, the ATO expect that trustees would know the asset value at acquisition, potential for capital gains and income producing capacity. Without knowing the above, it would be difficult to justify an investment for retirement purposes.

On an annual basis, the trustees need to be able to provide the following:

- Current market valuation
- Insurance documentation
- Signed asset declaration minute including confirmation of storage if applicable
- Current lease agreement (where applicable) and rental assessment (every 3 years)

In-house assets

An in-house asset is defined as:

- A loan to, or an investment in a related party of a fund
- An investment in a related trust of a fund
- An asset of a fund (other than business real property) that is subject to a lease or lease arrangement between the trustees of an SMSF and a related party of the fund

Where an SMSF holds an in-house asset, the value of all assets needs to be determined at the end of each financial year to assess the market value ratio and ensure that in-house assets are less than 5% of the fund's total assets. It is imperative that market values are accurate for in-house assets to ensure compliance with legislation. A valuation can be undertaken by anyone, but it must be based on objective and supportable data. An external Independent valuation would be recommended in cases where the valuation is likely to be complex.

Auditors approach to valuations

Auditors check that assets are being reported at market value and make a judgement on whether the valuations are appropriate given the nature of the assets involved. Depending on the level of audit evidence available and their professional judgement they may issue a qualified audit report, a disclaimer of opinion or an adverse opinion; and an Auditor Contravention Report (ACR) may be necessary.

Financial thresholds exist above which and auditor will lodge an ACR. These include any event where the contravention represents greater than 5% of the fund's assets and in all events where the contravention is greater than $30,000. In instances of valuations where an accurate value may not be immediately available, auditors can use their professional judgement and lodge an ACR. Where an ACR is lodged an ATO audit may commence depending on the risk assessment of the ATO.