

30 June 2022

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
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AUSTRALIA

Via website: www.aasb.gov.au

Dear Keith

Exposure Draft (ED) 320, Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

As the representatives of over 300,000 professional accountants, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Exposure Draft (ED).

We appreciate the AASB's efforts to develop guidance to assist not-for-profit (NFP) public sector entities apply the fair value requirements of AASB 13 *Fair Value Measurement* (AASB 13) to assets primarily held for their service potential. Many stakeholders have keenly sought additional implementation guidance on the principles in AASB 13 for these types of assets in order to prepare and audit consistent and comparable financial information. Particularly complex issues, which have now been addressed by this ED, are the following:

- Identifying appropriate market participants,
- Assessing highest and best use for specialised assets, and
- Calculating current replacement cost.

We believe the proposals in ED 320 are a reasonable and measured approach to the complexities of the above implementation challenges and the associated professional judgements. We also agree that the proposals in the ED address the variety of other issues by setting out logical, pragmatic and consistent responses.

Therefore, overall, we support the AASB's proposals.

However, while we expect the proposed guidance will reduce the challenges stakeholders face with fair value measurement, feedback we have received from our members indicates that, in some instances, they will continue to encounter practical difficulties in implementing the proposed requirements. In these instances, additional clarification of key terms or further guidance will be needed to provide clearer direction and reduce the associated measurement uncertainty. We have identified where this additional clarification or guidance is required in our responses to the specific questions raised in the ED, which are included in the **Attachment** to this submission.

If you have any questions about our submission, please contact either Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Attachment

Scope

1. **Do you consider that the proposed authoritative implementation guidance should be applicable also to NFP entities in the private sector? Please provide reasons to support your view.**

The use of fair value is not mandated in the NFP private sector in the same way as it is in the NFP public sector. Feedback from our members is that the NFP private sector does not have the same level of difficulty applying the principles in AASB 13.

However, we support transaction neutrality as a general principle and consider that private sector NFPs using AASB 13 would face similar valuation and implementation issues to those of public sector NFPs. The AASB's proposed guidance provides sensible and pragmatic support for many of the judgment issues faced by NFPs more generally, and so the use of this guidance by private sector NFPs should promote consistency in application and more useful information to users.

We therefore agree that this guidance should be available to NFPs in both the private and public sector if they are adopting AASB 13.

2. **Do you agree with the AASB's conclusion that determining appropriate measurement techniques for measuring the fair value of land and improvements on land subject to public-sector-specific legal restrictions is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards (see paragraphs BC164–BC170)? Please provide reasons to support your view.**

We agree with the AASB's conclusion. Feedback from our members is that the nature and impact of restrictions on specific assets varies considerably and so assessing this impact is best left to the detailed valuation assessments. We agree with the commentary (in paragraph BC166 of the Basis for Conclusion to the ED (BC)) that the current requirements of AASB 13 enable a largely consistent approach to measurement for affected types of asset classes. We also agree that if a level of government requires a more specific level of measurement consistency for entities within its jurisdiction, it would be better placed, than the AASB, to provide the jurisdictional specific guidance necessary to achieve this consistency.

Market participant assumptions

3. **In respect of the assumptions used in measuring the fair value of a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, do you agree with the proposals in paragraphs F4–F7 that:**
 - a. **if the market selling price of an identical asset is directly observable, that price (which incorporates implicitly the assumptions that other market participants would use when pricing the asset, negating the need to identify those assumptions) should be used to estimate the fair value of the asset; and**

- b. if the market selling price of an identical asset is not directly observable, the entity would need to explicitly estimate the pricing assumptions that other market participants would use. In this case, to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:
- i. if all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity should use those assumptions in measuring the fair value of the asset; or
 - ii. if not all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity would need to develop unobservable inputs in measuring the fair value of the asset. When applying paragraph 89 to develop unobservable inputs, the entity should use its own assumptions as a starting point and make adjustments to those assumptions if reasonably available information indicates that other market participants would use different data; or
 - iii. if no relevant information about other market participant assumptions is reasonably available, the entity should use its own assumptions in measuring the fair value of the asset?

Please provide reasons to support your view.

We agree that the above proposals should make the application of these requirements more practical for the reasons set out in the BC (paragraphs BC23-31). Mandating an option that is permissible under AASB 13 should provide more consistency in approach and the proposed revisions to the structure of paragraph 89 of AASB 13 are helpful in making the requirement clearer.

4. **Paragraph F8 provides examples of assets for which:**
- a. **market selling prices of an identical or a comparable asset are unlikely to be directly observable; and**
 - b. **no relevant information about different assumptions of other market participants is likely to be reasonably available.**

Do you agree with the examples in paragraph F8? Please provide reasons to support your view.

Examples provided in paragraph F8 are infrastructure (e.g., roads, drainage and sewerage works), prisons, parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, community facilities (e.g., toilet blocks) and most defence weapon platforms.)

We agree that these examples generally represent assets which provide essential but often unique or location specific services. This means they are unlikely to be duplicated or disposed of without some significant change to the activities or services available to the communities they are designed to serve. This makes the existence of comparable assets, or market participants interested in providing or using these assets in a similar manner, unlikely on an ongoing basis.

Highest and best use

5. Do you agree with the proposal in paragraphs F9–F11 that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use should be rebutted when, and only when, the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or to use the asset for an alternative purpose? Please provide reasons to support your view.

We agree that the current location and initial condition of most assets held for their service potential in the public sector have been deliberate choices made at some point to best serve community needs. We therefore agree that valuing such assets at their current locations represents their highest and best use. We also agree that this presumption should only change when the decision is made to change the asset's use (via sale or repurposing for a different use).

That is, we agree that a decision to change the asset's use should be a necessary condition to rebut the highest and best use presumption and change the measurement basis.

However, feedback from our members is that there needs to be clear alignment of these proposals with those currently required by AASB 5 *Non-Current Assets Held for Sale and Discontinued Operations* (AASB 5), given the complexity and length of the approval processes that are associated with government decisions at all levels.

6. Do you agree with the example in paragraph F10 of steps that might, in some circumstances of a particular entity, need to be completed before the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or use the asset for an alternative purpose, namely:
- relevant field studies or a Ministerial briefing on whether there is a market for the asset (and, if so, its likely price) or for the alternative services that the asset could be used to provide;
 - initial due diligence processes to determine that a sale of the asset or an alternative use of the asset is possible within the current socio-economic environment and would maximise the asset's value; and
 - development of project milestones and expected timelines to complete the sale or the plan to use the asset for the alternative purpose? Please provide reasons to support your view.

Examples provided in F10 are

- relevant field studies or a Ministerial briefing on whether there is a market for the asset (and, if so, its likely price) or for the alternative services that the asset could be used to provide;*
- initial due diligence processes to determine that a sale of the asset or an alternative use of the asset is possible within the current socio-economic environment and would maximise the asset's value; and*
- development of project milestones and expected timelines to complete the sale or the plan to use the asset for the alternative purpose.*

We agree that in order to rebut the presumption that the current use of an asset is its highest and best use, it is important to ensure that there is sufficient evidence of a commitment to pursue that different option that will justify the change in valuation.

However, consistent with our response to question 5, feedback from our members is that there needs to be a clearer alignment of these proposals with those currently required by AASB 5 given the complexity and length of the approval processes that are associated with government decisions at all levels.

7. **Do you agree with the proposal in paragraph F12 that an entity is only required to assess whether a use of the asset is physically possible, legally permissible, and financially feasible in accordance with paragraph 28 when (per paragraph F9) the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use is rebutted? Please provide reasons to support your view.**

We agree with the proposal. The feedback from our members is that this is a sensible, pragmatic approach that balances the costs of obtaining additional information with the benefits that can be obtained from that information.

8. **Do you agree with the draft implementation guidance in paragraph F13 for applying the 'financially feasible use' concept described in AASB 13 paragraph 28(c), namely that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, a use is financially feasible if market participants (including NFP public sector entities) would be willing to invest in the asset's service capacity, considering both the asset's ability to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services? Please provide reasons to support your view.**

We support the draft implementation guidance. We agree that if an entity would be willing to invest in the service capacity of the asset, this amounts to a recognition that there is ongoing value of that asset's service potential that it is financially feasible to support.

Application of the cost approach

Questions 9–16 relate to applying the cost approach under AASB 13 paragraphs B8–B9.

9. **Do you agree with the proposal in paragraph F14(a) that the entity should assume the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location? Please provide reasons to support your view.**

We agree with this proposal. Feedback from our members is that this is a reasonable and pragmatic approach to resolving this complicated judgement issue, eliminating the need for dealing with the complexities associated with asset measurement in a cheaper location.

10. **Do you agree with the proposal in paragraph F14(b) that the entity should assume that the asset subject to measurement (the subject asset) presently does not exist; and therefore, all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date should be included in the asset's current replacement cost? Please provide reasons to support your view.**

We agree with these proposals given that assuming the asset does not exist will ensure the identification and capture of all the costs that would be necessary to replace it, and so would more fairly reflect the actual value represented by it.

However, as noted in our cover letter, feedback from our members indicates that it would be difficult to reliably measure all the “necessary” and “intrinsically linked costs” without additional implementation guidance on these concepts. This is because this approach represents a hypothetical, rather than an actual, asset construction. As such, replacement could be open to a range of possible assumptions, including borrowing cost options and construction costs associated with greenfield versus brownfield issues.

- 11. Do you agree with the proposal in paragraphs F14(b) and F14(c) that, when estimating the current replacement cost of the subject asset, the entity should estimate the replacement cost of a reference asset (i.e., a modern equivalent asset or a replica asset) as input and adjust the estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset? Please provide reasons to support your view.**

We support aligning the principles of this guidance with those of the International Valuation Standard IVS 105 *Valuation Approaches and Methods*.

- 12. Do you agree with the proposal in paragraph F15(a) that once-only costs that would be expected to be necessarily incurred in a hypothetical acquisition or construction of the subject asset should be included in that asset’s current replacement cost? Please provide reasons to support your view.**

Consistent with our response to question 10 we agree that assuming the asset does not exist will enable capture of all costs that will be incurred to construct it initially and so will then more accurately reflect the actual value represented by it.

However, as noted in our cover letter, the feedback from our members indicates that it would be difficult to reliably measure all the “necessary” and “intrinsically linked costs”, without additional implementation guidance on these concepts, due to the difficulties associated with identifying costs associated with those assets that will actually be replaced.

- 13. Do you agree with the proposal in paragraph F15(b) that, when estimating the current replacement cost of the subject asset, an entity should determine, based on the circumstances of the subject asset, whether the following costs would (among other costs) need to be incurred upon the hypothetical acquisition or construction of that asset at the measurement date:**
- a. **unavoidable costs of removal and disposal of unwanted existing structures on land; and**
 - b. **any disruption costs that would hypothetically be incurred, when acquiring or constructing the subject asset at the measurement date, including costs of restoring an asset not controlled by the consolidated group (if any) to which the entity belongs? Please provide reasons to support your view.**

- a) We agree with this approach in principle, but feedback from our members is that it could be problematic to implement in practice due to the challenges of sourcing the necessary information. We therefore recommend the inclusion of additional guidance to assist entities deal with inadequate information.
- b) We agree with this approach in principle, but feedback from our members is that it could be problematic to apply in practice because many such costs are external to the entity or group, and so estimating and auditing these costs for inclusion in the calculation could be difficult. We therefore recommend the inclusion of additional guidance to assist entities deal with inadequate information.

- 14. Do you agree with the proposal in paragraph F15(c) that an NFP public sector entity includes in the subject asset's current replacement cost all necessary costs required to be incurred in the context of the entity's expected manner of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity? Please provide reasons to support your view. Please note that Illustrative Examples 1 and 2 illustrate the application of paragraphs F14 and F15.**

We agree that this is the most pragmatic approach to reflecting the true value currently reflected in the measured value of the asset. This is what the entity is seeking to identify in a replacement asset.

Economic obsolescence

- 15. Do you agree with the proposal in paragraph F16 that identifying economic obsolescence should not be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity? Please provide reasons to support your view.**

We agree with the proposal for the reasons set out in the BC (paragraphs BC134-141), including seeking consistency with the International Public Sector Accounting Standards Board (IPSASB) Conceptual Framework.

- 16. Do you agree with the proposal in paragraph F17 and the example in paragraph F18 that economic obsolescence should not be identified for any 'surplus capacity' of an asset that is necessary for stand-by or safety purposes (e.g. to deal with contingencies), even if it seldom or never is actively utilised? Please provide reasons to support your view.**

We support this proposal because such capacity is necessary for "insurance" purposes and for prudent management of the asset. This approach is also consistent with the IPSASB Conceptual Framework. However, we suggest providing some examples of scenarios where such "surplus capacity" can be identified to assist with a better understanding of this concept and applying it when measuring the fair value of an affected asset.

Application of the proposed implementation guidance

- 17. Do you agree with the proposal in paragraph AusC6.1 that the proposed authoritative implementation guidance set out in Appendix F should be applied prospectively? Please provide reasons to support your view.**

We agree with the proposal. Feedback from our members is that retrospective application of these proposals could be problematic, requiring the search for historical information that is not readily available and so which is also difficult to audit. We believe that the concerns about comparability and consistency resulting from a prospective change can be mitigated by adequate disclosure of the impact of the change when it occurs.

- 18. If you agree with prospective application in Question 17, do you consider that it would be appropriate for the AASB to provide an option for an NFP public sector entity to elect to restate comparative information as if the authoritative implementation guidance in Appendix F had been applied from a preceding period? Please provide reasons to support your view.**

While we support prospective implementation for this guidance, we also recognise that retrospective application improves comparability and increases the quality of information available to users. Therefore, an entity should have the option to choose retrospective application if it is cost beneficial for them to do so.

- 19. If you consider it appropriate for the AASB to provide an option for an NFP public sector entity to restate comparative information (see Question 18), do you consider it appropriate that, if an entity elects to restate comparative information, it should be required to disclose the amount of the adjustment for each financial statement line item affected, as if the implementation guidance had:**
- a. always been applied (i.e. full retrospective application in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors); or**
 - b. been applied from a specific preceding period, for example, the beginning of the immediately preceding period presented in the financial statements (i.e. modified retrospective application)? If so, please specify which preceding period you think would be appropriate. Please provide reasons to support your view.**

We support option (b) on the basis that full retrospective application is likely to have limited usefulness given the age and uncertainty of the historical information that would be required to implement the approach in option (a).

- 20. Further to Question 19, do you consider it would be appropriate for such optional restatements, if elected, to be required for all affected assets, except to the extent it is impracticable for the entity to determine either the period-specific effects of the implementation guidance or the cumulative effect of the change? Please provide reasons to support your view.**

We believe that if an entity is choosing the retrospective application option, this should be applicable to all affected assets, otherwise prospective application is a more appropriate choice.

- 21. Do you agree that the proposed authoritative implementation guidance set out in Appendix F should be applied for annual periods beginning on or after 1 January 2024, with earlier application permitted? Please provide reasons to support your view.**

We agree with the proposed application date and with permitting early adoption. The need for this guidance to promote consistency in the application of AASB 13 is well recognised and we believe the proposed application date provides adequate time for implementation.

General matters for comment

- 22. Whether the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft?**

In our view the issues associated with the application of fair value in the NFP public sector are of sufficient magnitude and complexity that they justify the preparation of Australian specific guidance to support the implementation of AASB 13, consistent with paragraph 24 of the AASB's NFP Standard-Setting Framework.

- 23. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?**

In our view these proposals will improve the application of AASB 13 in the NFP public sector.

- 24. Whether, overall, the proposals would result in financial statements that would be useful to users?**

We believe the guidance addresses many issues that have been of considerable concern to public sector stakeholders implementing AASB 13 and so will be valuable in promoting consistency of implementation. This will improve clarity and understanding for users.

25. Whether the proposals are in the best interests of the Australian economy?

We believe the guidance addresses many issues that have been of considerable concern to stakeholders implementing fair value requirements in the NFP public sector.

26. Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?

Feedback we received from our members is that auditing and assurance challenges could arise from the following proposals, if additional guidance is not provided:

- Identification of costs included in current replacement cost (see our response to question 13)
- Retrospective application (see our response to question 17).

27. Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

In our view the proposals will provide greater clarity on key implementation requirements of AASB 13 in the NFP public sector, reducing the implementation costs associated with complying with this standard.