



<b>Project:</b>	<b>IPSASB Exposure Drafts on Public Sector Measurement</b>	<b>Meeting:</b>	AASB June 2021 (M181)
<b>Topic:</b>	<b>Current value measurement of operational assets</b>	<b>Date of this paper:</b>	7 June 2021
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		<b>Project Priority:</b>	Medium
		<b>Decision-Making:</b>	High
		<b>Project Status:</b>	Decide comments on some proposals in ED 76 and ED 77

## Objective of this staff paper

1. In respect of IPSASB Exposure Drafts ED 76 *Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements* and ED 77 *Measurement*, the objective of this staff paper is for the Board to **tentatively decide**, subject to feedback received in outreach activities, the comments to make to the IPSASB regarding:
  - (a) the IPSASB's rationale that fair value is inappropriate for measuring the current value of operational assets;<sup>1</sup> and
  - (b) the Board's view on whether the proposed current operational value measurement basis would be likely to be appropriate for measuring the current value of operational assets.

## Introduction

2. The IPSASB concluded that fair value is inappropriate for measuring the current value of operational assets. In contrast, when issuing AASB 13 *Fair Value Measurement* in 2011 when IFRS 13 *Fair Value Measurement* was issued, the Board had decided that fair value is applicable to such assets and decided not to include any not-for-profit (NFP) entity modifications to IFRS 13 in AASB 13 (other than some disclosure relief).
3. However, the Board received feedback on the AASB's *Agenda Consultation 2017–2019* (ITC 34) that requested guidance to assist application of AASB 13 in the NFP public sector. Therefore, the Board added the *Fair Value Measurement for Not-for-Profit Entities* project (FVM project) to its work program in response to the feedback received.

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1 For ease of reference in this paper, 'operational assets' refers to 'non-financial assets of a not-for-profit public sector entity not held primarily for their ability to generate net cash inflows' (i.e. assets held primarily for their service potential or 'operational capacity').

4. The Board decided to consider the ongoing progress and outcomes of the IPSASB project, and their potential implications for current value measurements of operational assets before considering whether to propose amendments to AASB 13 in respect of operational assets. A key issue the Board will monitor is whether fair value or another current value should be the current value measurement basis for operational assets. Some of the key issues on which fair value guidance has been requested by Australian public sector stakeholders parallel the concerns raised by the IPSASB's constituents about fair value, which led to the IPSASB's decision that fair value is inappropriate for measuring the current value of operational assets.
5. Therefore, this paper explores:
  - (a) the IPSASB's rationale that fair value, current cost (in the IASB's *Conceptual Framework for Financial Reporting* (i.e. the Revised Conceptual Framework (RCF)), and replacement cost (in the IPSASB's existing Conceptual Framework) are inappropriate for measuring the current value of operational assets; and
  - (b) the key features of the proposed current operational value measurement basis in ED 76 and ED 77 and the Alternative Views thereon of two IPSASB members, to assess whether the proposed current operational value measurement basis would be likely to be an appropriate measurement basis for measuring the current value of operational assets.
6. Accordingly, the subject of this paper is the current value measurement bases considered by the IPSASB in respect of operational assets. This paper does not include analysis of other measurement bases or issues regarding measurement of other assets or liabilities.
7. Staff expect to develop a paper about application issues on the proposed current operational value measurement basis for deliberation at the August 2021 meeting. That paper would include some topics the Board has previously reached tentative views on, but in the context of fair value, as part of its deliberations in its FVM project.
8. Based on the Board's feedback at this meeting and the August meeting, and feedback received on AASB ITC 45,<sup>2</sup> staff will prepare a draft submission letter for consideration at the September 2021 meeting.

### Structure of this paper

9. This paper is set out in four sections:
  - [Section 1](#): The IPSASB's rationale that fair value is inappropriate for measuring the current value of operational assets
  - [Section 2](#): Staff's analysis of fair value measurement of operational assets
    - [2.1](#) The AASB's tentative decisions regarding fair value measurement of operational assets
    - [2.2](#) Analysis of the IPSASB's rationale for rejecting fair value

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2 The Board issued AASB ITC 45, [Request for Comment on IPSASB Exposure Drafts ED 76 \*Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements\* and ED 77 \*Measurement\*](#), on 11 May 2021. Comments are due by 3 August 2021.

[2.3](#) Rationale for supporting an alternative measurement basis to fair value

[Section 3:](#) Analysis of the key features of the IPSASB's proposed current operational value measurement basis

[3.1](#) Measuring an asset's current value based on its current use and ignoring alternative uses and reinvestment potential

[3.2](#) Measuring an asset's current value based on an entity-specific entry value vs market-participants-based exit value

[3.3](#) Measurement techniques in measuring the current operational value of an operational asset

[3.3.1](#) The use of the income approach in estimating the current operational value of an operational asset

[3.3.2](#) Current value measurement should focus on the cost of replacing an operational asset

[Section 4:](#) 'Current cost' and 'replacement cost' measurement bases as possible alternatives to fair value for measuring the current value of operational assets

## Summary of staff views

10. The staff views in this paper are summarised below:

- (a) the IPSASB's explanation of why it concluded that fair value is inappropriate for measuring the current value of operational assets should be expanded to provide better justification of that conclusion. Despite this, because of the vexed nature of the debate about fair value measurement of operational assets in Australia, staff consider there is merit in the IPSASB considering an alternative measurement basis to fair value (although not necessarily current operational value) as a practical solution ([Section 2.2](#) and [Section 2.3](#));
- (b) measuring an operational asset's current value based on its current use (and ignoring alternative uses and reinvestment potential) would be unlikely to reflect the full service potential of the asset to the entity and, therefore, unlikely to meet the objective of current operational value that the IPSASB aims to achieve ([Section 3.1](#));
- (c) because the same measurement techniques (income, market and cost approach) are permitted to estimate fair value and current operational value, apart from the treatment of transaction costs, it is not sufficiently clear in the IPSASB EDs how current operational value would differ from fair value in practice in most cases. Therefore, the current operational value measurement basis might not solve the Board's current concern that some operational assets, such as restricted land, are being measured under the market approach (instead of the cost approach), resulting in a value not reflecting the asset's service potential ([Section 3.2](#));
- (d) consistent with the Alternative Views expressed in the EDs, the current value of an operational asset should focus on the cost to replace the service potential embodied in the asset at the measurement date. Therefore:
  - (i) it would be inappropriate to allow an entity to use the income approach to measure an operational asset's service potential ([Section 3.3.1](#)); and
  - (ii) there might be merit for the IPSASB to consider extending the application of its replacement cost measurement basis to non-specialised operational assets, or consider

applying the current cost measurement basis under the IASB Revised Conceptual Framework, for measuring the current value of operational assets ([Section 3.3.2](#) and [Section 4](#));

- (e) the IPSASB seems to regard replacement cost and market prices as mutually exclusive values, with which staff would disagree because replacement cost (and the cost approach under fair value and current operational value) requires consideration of market prices of the components of an operational asset (paragraphs 92–96); and
- (f) the IPSASB’s explanation of why it concluded that ‘current cost’ in the IASB Revised Conceptual Framework and ‘replacement cost’ in the existing IPSASB Conceptual Framework are inappropriate for measuring the current value of operational assets should be expanded to provide better justification of those conclusions. Treating (current) replacement cost as a measurement technique rather than a measurement principle appears to have contributed to the mixed measurement principles in the current operational value measurement basis, where the proposals suggest that an operational asset’s service potential is measured using the income approach in some cases, which would be unlikely to result in a valuation reflecting the asset’s service potential (paragraphs 95–96).

**Section 1: The IPSASB’s rationale that fair value is inappropriate for measuring the current value of operational assets**

- 11. As noted in Section 1 of Agenda Paper 12.1, ED 76 and ED 77 propose a new current value measurement basis for operational assets:

Current operational value	<ul style="list-style-type: none"> <li>• entity-specific entry value</li> <li>• applicable to <b>operational assets</b>; whether <b>specialised or non-specialised</b></li> </ul> <p>“Current operational value is the value of an asset used to achieve the entity’s service delivery objectives at the measurement date.” (ED 77 para. 6)</p>
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- 12. Before deciding to propose the current operational value measurement basis, the IPSASB considered whether the existing three measurement bases outlined in Table 1 might be appropriate for measuring the current value of operational assets.

**Table 1: ‘Fair value’, ‘current cost’ and ‘replacement cost’**

Fair value (to conform to the fair value concept in IFRS 13)	<ul style="list-style-type: none"> <li>• market-participant-based exit value</li> <li>• excludes transaction costs</li> <li>• the IPSASB considers that fair value is applicable to <b>assets held for their financial capacity</b><sup>3</sup></li> </ul> <p>“Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date” (AASB 13 para. 9 and ED 77 para. 6)</p>
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<sup>3</sup> The IPSASB defines ‘financial capacity’ as “the capacity of the entity to fund its activities.” (ED 76 para. 7.3)

<p>'Current cost' in the AASB's Conceptual Framework for Financial Reporting (the Revised Conceptual Framework (RCF)).</p> <p>The IPSASB has considered the AASB's RCF indirectly by considering the IASB's RCF.</p>	<ul style="list-style-type: none"> <li>• entry value</li> <li>• includes transaction costs</li> <li>• is distinct from the cost approach to measuring fair value under AASB 13</li> <li>• its application is not specified in the AASB's revaluation requirements</li> </ul> <p>"The current cost of an asset is the <b>cost of an equivalent asset at the measurement date</b>, comprising the consideration that would be paid at the measurement date <b>plus the transaction costs</b> that would be incurred at that date... Current cost, like historical cost, is an <b>entry value</b>: it reflects prices in the market in which the entity would acquire the asset" (emphasis added, RCF para. 6.21)</p>
<p>'Replacement cost' in the existing IPSASB Conceptual Framework</p>	<ul style="list-style-type: none"> <li>• entity-specific entry value</li> <li>• applicable mainly to <b>specialised operational assets</b> where market buying prices for similar assets are unlikely to be available</li> <li>• to be replaced by current operational value under the proposals in ED 76 and ED 77</li> </ul> <p>"Replacement cost is the <b>most economic cost required for the entity to replace the service potential of an asset</b> (including the <b>amount that the entity will receive from its disposal at the end of its useful life</b>) at the reporting date." (emphasis added, IPSASB Conceptual Framework para. 7.37)</p>

13. The IPSASB's reasons for rejecting those measurement bases for operational assets are summarised in paragraphs 14–16. Copies of ED 76 and ED 77 are included as attachments to AASB ITC 45 in the supplementary folder for the Board's reference.
14. **IPSASB's conclusions about IFRS 13's fair value:** The IPSASB noted comments received on its April 2019 Measurement Consultation Paper that some constituents were concerned that fair value is difficult and inappropriate to apply to an operational asset because the 'highest and best use' and 'maximising the use of market participant data' concepts are generally not applicable to operational assets. (ED 77 para. BC29) The IPSASB considers that holding an asset to meet a service delivery objective often results in an asset being held in a capacity other than one that satisfies its highest and best financial use. (ED 77 para. BC32) In addition, the IPSASB states in ED 76 paragraphs 7.39–7.42 that the market for some operational assets may not be orderly, particularly if an asset is unique or rarely traded. In such circumstances, fair value (exit price) may not reflect the asset's value to the entity because an asset's capacity to provide services may mean that the asset's value to the entity exceeds its current purchase price.
15. **IPSASB's conclusions about IASB's 'current cost':** ED 76 para. BC.27 states that the IPSASB considered whether to adopt current cost as described in the IASB's RCF (which is the same as the AASB's RCF adopted for for-profit entities) as a current value measurement basis for operational assets. "The IPSASB formed a view that a measurement basis similar to current cost is relevant in a public sector context for both specialized assets and non-specialized assets held for operational capacity. However, rather than the **cost of an equivalent asset** in the IASB's

definition of current cost the IPSASB formed a view such a measurement basis should reflect an **asset's existing use in delivering services.**" [emphasis added]

16. **IPSASB's conclusions about 'replacement cost'**: ED 76 para. BC7.33 states that the IPSASB considered that 'replacement cost' as described in the existing IPSASB Conceptual Framework is an appropriate measurement basis for **specialised assets**, which should provide information on the **cost of service potential that is attributable to the asset**. However, the IPSASB is also of the view that **current operational value is a more versatile** measurement basis, as it can be applied to both specialised and non-specialised assets. It noted in ED 76 para. BC7.27 that the current replacement cost of a non-specialised asset can be supported by market-based measurement techniques with similarities to market value; whereas, the current operational value of a specialised asset can be determined using other measurement techniques.

### ***Key features of the proposed current operational value measurement basis***

17. The IPSASB proposes to adopt IFRS 13's concept of fair value for assets held for their financial capacity and, for the reasons in paragraphs 14–16, it proposes to establish a new measurement basis – current operational value – for operational assets.
18. ED 77 para. 25 summarises the key features of current operational value and how it differs from fair value:
  - (a) it is explicitly an entry value rather than an exit value;
  - (b) it reflects the value of an asset in its current use, rather than the asset's highest and best use; and
  - (c) it is entity-specific and therefore reflects the economic position of the entity, rather than the position prevailing in a hypothetical market.
19. To assist the Board's analysis of the conceptual arguments for the IPSASB to introduce a new measurement basis for operational assets (rather than applying fair value or another measurement basis), [Section 2](#) of this paper provides a high-level summary of the Board's tentative decisions regarding fair value measurement of operational assets (in particular, how applying the fair value concept in AASB 13 arguably can provide appropriate current value measures of operational assets held by NFP entities). It also assesses the IPSASB's rationale for concluding that fair value is inappropriate for measuring the current value of operational assets.

### **Section 2: Staff's analysis of fair value measurement of operational assets**

20. At the time of issuing AASB 13, the Board considered that even though many non-financial assets in the public sector might have a specialised nature or that observable market inputs might not be readily available, a public sector entity would be able to measure the fair value of such assets at current replacement cost, under the cost approach in IFRS 13.
21. The Board noted in its informal targeted outreach in 2019-2020 as part of its FVM project that, other than restricted land, NFP public sector entities indeed apply the cost approach in measuring the fair value of most operational assets. Those Australian public sector stakeholders who responded to those informal targeted outreach activities commented that

measuring the fair value of those assets using the cost approach, instead of the market or income approach, appropriately reflects the service potential of the asset.<sup>4</sup>

22. As mentioned in paragraph 3, the Board received comments from Australian public sector stakeholders that guidance is needed to clarify some fair value application issues. Three of the key issues on which fair value guidance has been requested<sup>5</sup> parallel the concerns raised by the IPSASB's constituents, which led to the IPSASB's decision that fair value is inappropriate for measuring the current value of operational assets. They are:
- (a) Identifying the highest and best use of an operational asset, including how physical characteristics of an asset and legal restrictions imposed on the use of an asset or the prices that may be charged for using an asset should be considered when determining an asset's highest and best use;
  - (b) Identifying who are the market participants for the purchase or sale of an operational asset, in particular when an operational asset has restrictions; and
  - (c) when to measure the fair value of a non-financial asset using the cost approach (i.e. at current replacement cost).

## 2.1: The AASB's tentative decisions regarding fair value measurement of operational assets

23. This section provides a high-level summary of the Board's tentative views on the three topics mentioned in paragraph 22.<sup>6</sup> The Board reached those views based on its interpretation of the following paragraphs in the Basis of Conclusions accompanying IFRS 13. IFRS 13 para. BC78–BC79 state (emphasis added):

BC78 Some respondents to the exposure draft expressed concerns about using an **exit price notion for specialised non-financial assets** that have a significant value when used together with other non-financial assets, for example in a production process, but have little value if sold for scrap to another market participant that does not have the complementary assets. They were concerned that an exit price would be based on that scrap value (particularly given the requirement to maximise the use of observable inputs, such as market prices) and **would not reflect the value that an entity expects to generate by using the asset in its operations**. However, IFRS 13 clarifies that this is not the case. In such situations, the **scrap value for an individual asset would be irrelevant because the valuation premise assumes that the asset would be used in combination with other assets** or with other assets and liabilities. Therefore, an **exit price reflects the sale of the asset to a market participant that has, or can obtain, the complementary assets and the associated liabilities needed to use the specialised**

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4 However, the majority of those stakeholders commented that the market approach would be more appropriate in measuring the fair value of restricted land.

5 Appendix A of [Agenda Paper 8.1](#) of the April 2019 AASB meeting summarises the key issues on which fair value guidance has been requested by Australian public sector stakeholders.

6 Those tentative views are subject to the Board's redeliberations in light of developments in relation to the IPSASB's Measurement project (including feedback received on AASB ITC 45).

**asset in its own operations.** In effect, the **market participant buyer steps into the shoes of the entity that holds that specialised asset.**

BC79 It is unlikely in such a situation that a market price, if available, would capture the value that the specialised asset contributes to the business because the market price would be for an unmodified asset. When a market price does not capture the characteristics of the asset (eg if that price represents the use of the asset on a stand-alone basis, not installed or otherwise configured for use, rather than in combination with other assets, installed and configured for use), that price will not represent fair value. In such a situation, an entity will need to **measure fair value using another valuation technique** (such as an income approach) **or the cost to replace or recreate the asset** (such as a cost approach) depending on the circumstances and the information available.

***Hypothetical market participant buyer of an operational asset***

24. The IASB noted in IFRS 13 para. BC78–BC79 that fair value is applicable to measurement of a specialised non-financial asset, albeit in the context of a for-profit entity holding the asset for its financial capacity. The Board has tentatively decided that the IASB’s rationale in IFRS 13 para. BC78 can logically be extended in an NFP entity context to any assets (whether specialised or not) that contribute more to an entity when used together with other assets than their selling price to an entity without the complementary assets. The Board also considered that a ‘market participant buyer stepping into the shoes of the NFP public sector entity holding the operational asset’ obtains value from that asset:

- (a) by providing needed services to beneficiaries; and
- (b) through financial support (in the form of rates, taxes, grants and appropriations) and through any user charges.<sup>7</sup> In this sense, the operational asset being measured is regarded as being sold with complementary assets because the ‘market participant buyer stepping into the shoes of the NFP entity holding the operational asset’ would be willing to pay the asset’s current replacement cost in view of the entity-wide cash inflows (such as appropriations) it would gain access to.

25. The Board noted that the principles in (a) and (b) of paragraph 24 logically apply when the market participant buyer, because of its operational mandate, needs the service potential embodied in the operational asset and cannot acquire an asset without also acquiring other uses (because an asset with identical utility to the entity is not obtainable in the market place at the measurement date):

- (a) it has no use for; and
- (b) for which other market participant buyers would not be prepared to pay.

26. Furthermore, staff consider that, whenever the circumstances in paragraph 25 exist, from a market pricing perspective the asset would be ‘specialised’, in the sense that the market participant buyer would be prepared to buy the asset for its current replacement cost, whereas other market participants would not. This is despite the asset sometimes being restricted land, which many would regard as a non-specialised asset.

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<sup>7</sup> As documented in footnote 7 to paragraph BC47(a) of the [March 2020 working draft Exposure Draft](#) developed as part of the FVM project.

27. Consistent with the IASB’s view in IFRS 13 para. BC78 that “the market participant buyer steps into the shoes of the entity that holds that specialised asset” and based on the extended view noted in paragraph 24, the Board has tentatively decided that market-participants-based assumptions under AASB 13 would be the same as the assumptions of the entity holding the asset.

### ***Highest and best use***

28. In its FVM project, the Board considered that the highest and best use concept, other than its ‘financially feasible use’ aspect in some circumstances, should continue to be applicable to the measurement of non-financial assets of NFP entities. The Board tentatively decided that the financially feasible use aspect (as described in paragraph 28(c) of AASB 13) should not be applicable to measuring legally **restricted** operational assets of NFP entities when an equivalent restricted asset is not obtainable in the marketplace for a price supported by observable market evidence.
29. Paragraph 28(c) of AASB 13 refers to an asset’s highest and best use generating an investment return that market participants would require from an investment in that asset put to that use. For legally restricted operational assets, the Board considered that their fair value, measured at their current replacement cost, can exceed the amount on which a market participant buyer could generate a commercial (financial) rate of return.
30. The Board considered that the highest and best use concept should still be applicable for legally restricted operational assets that would be scoped out of the ‘financially feasible use’ aspect. For those assets, ‘highest and best use’ would take into account: (a) physically possible uses of the asset; and (b) any legal restrictions on the use of the asset that market participants would take into account when pricing the asset.<sup>8</sup> See [Section 3.1](#) for further discussion of measuring the current value of an operational asset based on its highest and best use rather than only its current use.

### ***Using the cost approach under fair value***

31. The Board considered AASB 13 is presently not sufficiently clear about how to measure the fair value of operational assets, particularly when such assets are subject to legal restrictions transferable to market participant buyers. This is because it is unclear whether the fair value of such legally restricted operational assets should be measured using the market approach or income approach where the resulting measures differ from the assets’ current replacement cost.
32. The Board has tentatively decided that, in relation to measuring the fair value of a legally restricted operational asset (whether land or another class of asset):
- (a) if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset’s fair value should be measured based on the available market evidence for the equivalent restricted asset (i.e.

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8 Legal restrictions on the use of an asset, in the broader context of the Board’s submission on IPSASB ED 76 and ED 77 (i.e. not confined to fair value measurement), are expected to be specifically addressed in agenda papers for the August 2021 Board meeting.

apply the market approach if there are observable market transactions involving **identical or comparable assets**)<sup>9</sup>; or

(b) if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset's fair value should be measured at its current replacement cost (i.e. the cost approach).

33. The Board's tentative view noted in paragraph 32(b) is intended to ensure legally restricted operational assets would be measured at a value faithfully representing the assets' service potential (See [Section 3.3.2](#) for further discussion about measuring the current value of operational assets at their replacement cost). This tentative decision is consistent with the requirement in AASB 1059 *Service Concession Arrangements: Grantors* to use current replacement cost to measure the fair value of a grantor's service concession assets (AASB 1059, paras. 7, 8 and 9(b)). This requirement reflected the Board's view that the service capacity embodied in the grantor's service concession asset is unaffected by granting the operator a right to toll (and thus reducing the grantor's cash flows by forgoing user charges), because the asset provides the same utility to the public regardless of who receives the user charges.
34. Measuring the grantor's service concession asset using the cost approach (current replacement cost), instead of the market or income approach, results in the same measure of the fair value of the asset regardless of which entity is ultimately receiving the user charges (AASB's Basis for Conclusions on AASB 1059, paragraphs BC50–BC53 and BC62–BC66).

## 2.2: Analysis of the IPSASB's rationale for rejecting fair value

35. As noted in paragraph 14, the IPSASB considers that the 'highest and best use' and 'maximising the use of market participant data' concepts are generally not applicable to operational assets.
36. As stated in BC32–BC33 of ED 77, the IPSASB's is of the view that (emphasis added):
- (a) holding an asset to meet a service delivery objective often results in an asset being held in a capacity other than its highest and best financial use;
  - (b) when an asset is held for its operational capacity, the **most relevant information to the users** of financial information is the current value of the asset in its **current use** because:
    - (i) it **reflects the amount an entity would incur** at the measurement date to **replace the capacity to achieve its present service delivery objective** using its existing assets; and
    - (ii) the consumption of the asset (through depreciation) reflects the **amount the entity would incur during the period to provide the service** at the prevailing prices when an asset is measured.
37. Current use "is the current way an asset or group of assets is used" (ED 77 para. B3).

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9 AASB 13 Appendix A defines the market approach as "A valuation technique that uses prices and other relevant information generated by market transactions involving **identical or comparable** (ie similar) assets ..." (emphasis added)

38. Staff agree that those two pieces of information noted in paragraph 36(b) – the amount an entity would incur at the measurement date to replace the capacity of the asset used to achieve its service delivery objectives, and the consumption of the asset – are highly relevant to users of financial information. Therefore, staff consider that the cost approach in current operational value described in ED 76 and ED 77 (which would measure the cost currently required to replace an asset used by an entity to provide services) would result in an appropriate current value measurement for operational assets. The depreciation calculated based on this amount would reflect the current cost of consumption of the asset.
39. The IPSASB stated in ED 77 paragraph BC32 that holding an asset to meet a service delivery objective often results in an asset being held in a capacity other than that of one that satisfies its **highest and best financial use**. It also included the following example of that view:
- “For example, an entity may have a service delivery objective to provide medical services to citizens of a city center. While operating a building the entity owns as a hospital may not be in the best financial interests of the entity, it does satisfy the service delivery objective.”
40. This example seems to imply that the IPSASB considers that the current value of a building being used as a hospital might worth less to the entity than if it was used in an alternative way. Staff disagree with this view. Staff consider that the current value of an operational asset, whether fair value or current operational value, should be measured based on its highest and best use – that is, based on the use of the asset that would maximise the value of the asset (AASB 13 Appendix A) (also see [Section 3.1](#) about whether an operational asset’s service potential should be regarded as including its ‘reinvestment potential’).
41. Staff agree with the argument in paragraph AV7 of Mr Beardsworth’s Alternative View on ED 76 (in the context of current operational value) that an operational asset’s service potential is best represented by the cost the entity is **currently required to incur in the marketplace** at the measurement date to replace the asset (emphasis added). The cost the entity is ‘currently required to incur in the marketplace’ measures the most economical means of replacing an asset’s service potential in the marketplace.
42. This is consistent with the Board’s tentative view (about fair value) described in paragraph 25 that there might be situations in which a NFP entity, in a hypothetical transaction, can only replace the service potential embodied in an operational asset by acquiring a replacement asset with additional uses that the entity has no current plan to use (because an asset with identical utility to the entity is not obtainable in the market place at the measurement date). In this case, the current value of the operational asset should be measured based on the cost of the asset it would need to acquire in that hypothetical replacement transaction, which would be a value reflecting the operational asset’s highest and best use rather than its current use.
43. Therefore, in the example stated in ED 77 paragraph BC32 (quoted in paragraph 39), staff consider that measuring the building’s current value based on the cost currently required to replace the building (and thus reflecting the building’s higher and better use than its current use as a hospital) would be appropriate. This is because this measurement would result in a valuation reflecting the service potential embodied in the building, and the resulting depreciation expense would reflect the current cost of consumption of the building’s service potential (which, as noted in paragraph 36(b), are the two pieces of information the IPSASB considers most relevant to users regarding the current value of an operational asset).
44. Staff also consider that, if an entity needs to operate an asset for a particular purpose in a particular location (e.g. it needs to provide a service in a particular location accessible to a particular cohort of beneficiaries), the entity-specific use of that asset should not be regarded

as being inconsistent with the entity's best financial interests. In this regard, any future funding of the entity typically would be affected by whether the entity delivers the needed service in that location.

45. The staff comments in paragraphs 38–44 are consistent with the Board's tentative decision (noted in paragraph 24) that a 'market participant buyer stepping into the shoes of the NFP public sector entity holding the operational asset' obtains value from that asset:
  - (a) by providing needed services to beneficiaries; and
  - (b) through financial support (in the form of rates, taxes, grants and appropriations) and through any user charges.
46. In addition, staff note that many assets deployed by NFP public sector entities are specialised and consequently their existing use is often their only conceivable use. This means that, for many assets deployed by NFP entities, concerns about the 'highest and use' assumption in fair value (even if accepted) should not cause fair value measurements to differ from the aims of the proposed current operational value measurement basis.
47. The Board reached a tentative view, as described in paragraph 27, that market-participants-based assumptions under AASB 13 would be the same as the assumptions of the entity holding the asset. Therefore, provided that the asset's current use is its highest and best use, 'market-participants-based assumptions' in fair value logically would be the same as the 'entity-specific assumptions' in current operational value.
48. Based on the analysis in paragraphs 35–47, and without further explanation by the IPSASB, staff did not identify a convincing conceptual argument why the IPSASB considered that the 'highest and best use' and 'maximising the use of market participant data' concepts are generally not applicable to operational assets and therefore that fair value is inappropriate for measuring the current value of operational assets.

### **2.3: Rationale for supporting an alternative measurement basis to fair value**

49. Staff consider that, prior to the Board completing the Measurement component of its project to adapt its Revised Conceptual Framework for adoption by NFP entities, it would be premature to express a view based on **conceptual grounds** about whether fair value remains appropriate for measuring the current value of operational assets.
50. Nevertheless, a central facet of both the existing Australian Conceptual Framework applicable to NFP entities and the IPSASB Conceptual Framework is the fundamental importance of reflecting the service potential of operational assets. Therefore, staff consider that the Board is well placed to start its assessment of the IPSASB's proposals with a position that, whichever term is used to describe a current value measurement basis for operational assets, the measurement basis needs to reflect the operational asset's service potential.
51. Given the Board's experience in attempting to address those contentious aspects of fair value for application in the Australian NFP public sector noted in paragraph 22, staff recommend that the Board expresses conditional support for the IPSASB developing an alternative measurement basis to fair value (although not necessarily the proposed current operational value measurement basis) as a **practical solution** in addressing those issues, regardless of the logic of asserting that fair value can cater for the service potential in operational assets.

52. At this meeting, staff are not asking the Board to form a firm view on the IPSASB’s proposed current operational value measurement basis for measuring the current value of operational assets but, rather, to consider exploring a measurement basis outside fair value.
53. Staff consider there are two main arguments from a practical perspective for departing from fair value for measuring the current value of operational assets:
- (a) the guidance on fair value in IFRS 13 is often applied in the public sector by valuing the assets from the perspective of private sector/for-profit market participant buyers, and it might be difficult to convince entities and their valuers to apply IFRS 13 in the manner described in paragraphs 23–32 in [Section 2.1](#), which has been the subject of considerable debate and confusion in the Australian NFP public sector. The unresolved debate about how to measure the fair value of operational assets, e.g. restricted operational assets, is partly due to the fact that AASB 13 defines fair value as an exit price but caters for entry prices as a surrogate for exit prices in some circumstances;<sup>10</sup> and
  - (b) consistent with staff’s views in [Section 3.3.2](#), there is a strong case for measuring operational assets focusing on the cost to replace the service potential embodied in them (entry price). This is broadly in line with the cost approach to measuring fair value under IFRS 13 (which is used by many Australian NFP public sector entities in measuring the fair value of their infrastructure and similar assets held primarily for their operational capacity). However, IFRS 13 requires an entity to apply whichever of the market approach, income approach or cost approach is considered most appropriate based on the availability of observable inputs. Modifying the requirements of IFRS 13 to allow only the cost approach to be applied for IPSAS might seem potentially inconsistent with the view of the IPSASB’s Consultative Advisory Group that the IPSASB should use terms consistently with those of the IASB unless there is a clear public sector reason to differ. That is, referring to ‘fair value’ but focussing on only the cost approach would seem to involve inconsistent use of IASB terminology.
54. [Section 3](#) of this paper explores the key features of the proposed current operational value measurement basis and how they differ from the features of fair value. The staff paper for the August 2021 meeting is expected to consider in further detail the IPSASB’s proposed guidance on how to measure an asset’s current operational value, including exploring likely application issues.

#### Question for the Board

- Q1: Do Board members agree with the staff view in paragraphs 49–53 that its submission to the IPSASB should:
- (a) not express a view based on conceptual grounds about whether fair value remains appropriate for measuring the current value of operational assets; and
  - (b) express a preliminary view in support of the IPSASB in developing an alternative measurement basis outside fair value (although not necessarily current operational

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10 For assets held primarily for their ability to generate net cash inflows, the Board has received comments from various valuation professionals that materially similar fair value measures should arise from using any of the market, income or cost approaches. However, for operational assets, considerably different measures of fair value might arise from applying the market, income or cost approaches.

value) as a practical solution in addressing current value measurement issues affecting operational assets?

### **Section 3: Analysis of the key features of the IPSASB's proposed current operational value measurement basis**

55. This section analyses the key features of the proposed current operational value measurement basis, and its differences from fair value, noted in paragraph 18. Specifically, this section examines whether current operational value would likely lead to a valuation reflecting the service potential of an operational asset and thus meet the measurement objective that the IPSASB has set out to achieve.

#### **Measurement objective**

56. ED 76 para.7.2 states that the objective of measurement is “to select those measurement bases that most fairly reflect the cost of services, operational capacity, and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.”
57. ED 76 para. 7.53 appears to explain the measurement objective of current operational value. It states that “... current operational value provides a **useful measure of the resources available to provide services in future periods**, as it is focused on the current value of assets and their **service potential to the entity.**” (emphasis added)
58. “Service potential is the capacity to provide services that contribute to achieving the entity’s objectives ...”. (IPSASB’s Conceptual Framework para. 5.8)

#### **3.1: Measuring an asset’s current value based on its current use and ignoring alternative uses and reinvestment potential**

59. ED 77 para. B4 states: “Measuring the current use of an asset **disregards potential alternative uses and any other characteristics of the asset that could maximize its market value.** For example, a building operated as a school is currently used as a school. Alternative uses, such as the operation of the building as an office block held for rental at market rates, are not considered ...” (emphasis added)

#### **Staff Analysis**

60. As quoted in paragraph 57, ED 76 para. 7.53 states that “... current operational value provides a **useful measure of the resources available to provide services in future periods**, as it is focused on the current value of assets and their **service potential to the entity.**” (emphasis added)
61. Staff consider that the phrase “resources available to provide services in future periods” in ED 76 para. 7.53 would include the asset’s potential to be sold for cash and be reinvested in other stores of service potential (staff refer this as the asset’s ‘reinvestment potential’). An example is a NFP post office in the city centre of a large city that has a potential to be used as a commercial building with a high resale value, compared with another NFP post office located in a small suburb with no potential alternative uses and a low resale value. Even if the two post offices have an identical capacity to provide postal services and identical remaining useful lives, the post office located in the city centre has the potential to provide more services to the entity because the entity could choose to sell it and reinvest the cash in other post offices.

62. Moreover, the replacement cost of an asset under the existing IPSASB Conceptual Framework – which the IPSASB has acknowledged is appropriate for specialised assets (in ED 76 para. BC7.33) – includes the amount that an entity will receive from disposal of the asset at the end of its useful life (IPSASB Conceptual Framework para. 7.37). The IPSASB has not provided a reason why it thinks its proposed new measurement basis should exclude this amount from an operational asset’s current value.

### Staff’s view

63. Staff consider that the IPSASB’s explanation of current operational value should be expanded to provide better justification for why it considered that measuring the current operational value of an asset should disregard potential alternative uses that could maximise its market value.

64. A measurement based on the current use of the asset – and ignoring alternative uses and reinvestment potential – would be unlikely to reflect the full service potential of the asset to the entity, and therefore less likely to achieve the objective of current operational value stipulated in ED 76 para. 7.53 than if the cost of replacing an asset’s reinvestment potential were also taken into account.

65. “Resources available to provide services in future periods” would include the asset’s potential to be sold for cash and be reinvested in the capacity to provide other public services. Therefore, a current value measurement of an operational asset should include the asset’s potential to be sold for cash. Consistent with that view, staff consider that alternative uses of the asset that could maximise “resources available to provide services in future periods” should be included in the operational asset’s current value measurement.

66. Staff also note that, if the objective of current value measurement is to reflect the full service potential of an operational asset (i.e. to provide a “useful measure of the resources available to provide services in future periods”), then the measurement should be based on the highest and best use of the asset – that is, based on the use of the asset that would maximise the value of the asset. For example, consider a parcel of land with harbour views that is currently being used as a storage space and has an alternative use to be sold and redeveloped into a residential property. The current value of this parcel of land should be measured at its highest and best use, which is residential use, which would include its potential redevelopment value.

### Question for the Board

Q2: Do Board members agree that its submission to the IPSASB should include the following views?

- (a) The IPSASB’s explanation of current operational value should be expanded to provide better justification for why that value should disregard potential alternative uses that could maximise its market value (paragraph 63).
- (b) A measurement based on the current use of the asset – and ignoring alternative uses and reinvestment potential – would be unlikely to reflect the full service potential of the asset to the entity, and therefore less likely to achieve the objective of current operational value stipulated in ED 76 para. 7.53 (paragraph 64).
- (c) The current value measurement of an operational asset should (paragraph 65):
  - (i) include the asset’s potential to be sold for cash; and, therefore,
  - (ii) take into account alternative uses of the asset that could maximise the resources available to the entity to provide services in future periods.

- (d) If the objective of current value measurement is to reflect the full service potential of an operational asset then the measurement should be based on the highest and best use of the asset (paragraph 66).

### 3.2: Measuring an asset's current value based on an entity-specific entry value vs market-participants-based exit value

67. ED 77 proposes that an asset's current operational value represents an **entry price** (para. B8–B9). However, the views of IPSASB members were divided regarding whether the proposed guidance on current operational value is consistent with an entry price perspective.

#### *Alternative Views expressed by two IPSASB members who support using current entry values to measure the current value of operational assets*

68. The Australian and New Zealand IPSASB members, Mr Blake and Mr Beardsworth, expressed an alternative view, as noted in paragraphs AV14–AV15 in ED 77. They expressed concern that the proposed definition of current operational value could permit either entry or exit values.
69. Paragraph 7.8 of the IPSASB Conceptual Framework states: "... **Exit values reflect the economic benefits from sale**. An exit value also reflects the **amount that will be derived** from use of the asset." And paragraph 7.19 of ED 76 states: "... Exit values reflect the **amount derived from use of the asset** and the **economic benefits from sale**." (emphasis added)
70. Mr Blake and Mr Beardsworth were of the view that permitting current operational value to be determined using the income approach, where an entity applies the discounted cash flow method using entity-specific assumptions for cash flows and the discount rate, could lead to the resulting measurement to be an exit value based on the description in paragraph 7.8 of the IPSASB Conceptual Framework and paragraph 7.19 of ED 76.
71. Mr Blake and Mr Beardsworth expressed concern in ED 77 para. AV15 that the potential use of both entry and exit values for the proposed current operational value measurement basis would be confusing for constituents. It would make it harder for them to identify the objective of the measurement and to identify which technique is most appropriate. This could lead to a lack of comparability.

#### **Staff Analysis**

72. Despite the focus on exit value in IFRS 13, the IASB noted in IFRS 13 para. BC79 (quoted in paragraph 23) that, in the context of specialised non-financial assets, measurement techniques might be used to estimate fair value. The techniques include measuring assets using market entry prices to estimate the cost to replace or recreate the asset (current replacement cost) as a surrogate for exit value.
73. ED 77 paras. B23 and C55 propose that, under both fair value and current operational value, when using measurement techniques (the market approach, income approach or cost approach) an entity shall maximise the use of relevant observable inputs and minimize the use of unobservable inputs. As noted in paragraph 27, the Board reached a tentative view that market-participants-based assumptions would be the same as the assumptions used by the entity holding the asset. Therefore, staff consider that the differences between current operational value and fair value (being a market-participants-based exit value) should, if the operational asset is being measured based on its highest and best use, be limited the treatment

of transaction costs. Current operational value includes transaction costs while fair value excludes transaction costs.

74. However, as discussed in [Section 3.3.1](#), staff consider that allowing an entity to use the income approach for operational assets would risk assets being measured at inappropriately low amounts not reflecting their service potential to the entity. Therefore, staff consider that, if maximising the use of observable inputs would entail use of the income approach to estimate the current operational value of an operational asset, the resulting valuation would be unlikely to reflect the asset's service potential.

#### Staff's view

75. Because IFRS 13 permits the use of entry values to estimate an asset's exit value, staff are of the view that, other than treatment of transaction costs, if IFRS 13 was applied in a manner that includes market participants with similar characteristics and objectives to those of the public sector reporting entity (noted in paragraph 27), fair value, being an exit value, would unlikely to differ from an entry value measurement (if the operational asset is being measured based on its highest and best use).
76. Even though 'economic benefits from sale' of an asset considered an exit value by the IPSASB, staff consider that the objective of current operational value (stipulated in ED 76 para. 7.53) to measure "the resources available to provide services in future periods" would include the asset's ability to be sold for cash (or its reinvestment potential) (See [Section 3.1](#)). This means that a potential apparent difference in principle between fair value and current operational value need not arise, depending on how the notion of current operational value is interpreted.

#### Question for the Board

Q3: Do Board members agree with staff's view in paragraph 75 that, other than treatment of transaction costs, if IFRS 13 was applied in a manner that includes market participants with similar characteristics and objectives to those of the public sector reporting entity, fair value would unlikely to differ from an entry value measurement?

### 3.3: Measurement techniques in measuring the current operational value of an operational asset

#### 3.3.1 The use of the income approach in estimating the current operational value of an operational asset

77. The key paragraphs in ED 77 about the use of income approach in estimating current operational value are included below (emphasis added):

B23 An entity uses measurement techniques that are appropriate in the circumstances and for which sufficient data are available to measure current operational value, **maximizing the use of relevant observable inputs** and minimizing the use of unobservable inputs.

B24 The objective of using a measurement technique is to **estimate the value of the asset used to achieve the entity's present service delivery objectives** at the measurement date under current market conditions. Three widely used measurement techniques are the market approach, the cost approach and the income approach ... An entity shall use

measurement techniques consistent with one or more of those approaches to measure current operational value.

**B38 The income approach converts future amounts (e.g., cash flows or revenues and expenses) to a single current amount. This approach may be applicable to estimate the value of an asset measured using the current operational value when:**

- (a) The use of multiple measurement techniques is appropriate (e.g., the use of a market approach and a present value technique). Present value (i.e., an application of the income approach) is a tool used to link future amounts (e.g., cash flows or values) to a present amount using a discount rate. When the timing of an outflow differs from the measurement date, that amount should be discounted to its value at the measurement date when estimating current operational value. For example, when establishing the current operational value of a school by reference to the construction of a substitute asset, i.e. the cost approach, costs incurred over the construction period should be discounted to the measurement date using the present value techniques outlined in the income approach ...
- (b) Information is unavailable to support the application of the market or cost approach. Discounting the future cash inflows generated by an asset will generally not reflect the amount an entity would currently incur to acquire its assets to be able to continue to achieve its present service delivery objectives. However, in some cases the income approach may be the best approximation of current operational value when cost or market information is unavailable. For example, heritage items that are naturally occurring, such as cave paintings, or natural resources are unlikely to have cost or market information related to the specific asset. However, the asset may generate cash inflows through tourism, a royalty stream, etc. that may be relevant in determining the current operational value.

78. ED 77 paras AV5–AV12 includes Alternative Views expressed by Mr Blake and Mr Beardsworth regarding the use of the income approach in measuring the current value of an operational assets. Their views are summarised below:

- (a) ED 77 requires an entity to maximise the use of observable inputs and minimise the use of unobservable inputs (ED 77 para. B23). Because more observable inputs might sometimes be available for the income approach than for the other techniques, allowing an entity to use the income approach for assets held for operational purposes runs the risk that assets will be measured at inappropriately low amounts, making it difficult for users to identify the remaining service potential of such assets.
- (b) They consider that replacement cost measures would more appropriately reflect the service potential embodied in assets and the current cost of providing services using those assets.

79. Mr Blake and Mr Beardsworth proposed an alternative definition of current operational value, which is “the cost to replace the service potential embodied in an asset at the measurement date.”

#### **Staff analysis**

80. Staff concur with the Alternative View summarised in paragraph 78(a) that allowing an entity to use the income approach for operational assets, which are not held primarily to generate net

cash inflows, would risk assets being measured at inappropriately low amounts and not reflecting their service potential to the entity.

81. Staff consider unconvincing the ‘school example’ of using the income approach in paragraph B38(a) of ED 77, where a school is constructed over a period of time. The differences between the dates on which market entry prices are observed and the measurement date typically are not addressed by discounting future amounts to their present value in practice. To estimate an item’s market entry price at the measurement date (when that price is not observable at that date), the common practice in the public sector is to inflate the most recently observed price by applying a price index, rather than discounting a *future* amount to its present value. That is, it is unlikely that the ‘discounted cash flow’ calculation within the income approach would be used.
82. Moreover, regarding paragraph B38(b) of ED 77, staff consider that the unavailability of information to support application of either the market approach or cost approach to an asset should seldom occur. In the absence of such information, it would be extremely difficult to assess whether applying the income approach would result in faithful representation of the asset’s current operational value. For example, a revenue stream might be attributable to a number of assets working together, rather than the asset that is the subject of measurement.

#### Question for the Board

Q4: Do Board members agree to include in its submission to the IPSASB a view that allowing an entity to use the income approach for operational assets would risk assets being measured at inappropriately low amounts not reflecting their service potential to the entity (paragraphs 80–82)?

### 3.3.2 Current value measurement should focus on the cost of replacing an operational asset

83. Paragraphs AV7–AV9 in ED 76 provide Mr Beardsworth’s further elaboration of the joint alternative view he and Mr Blake expressed regarding the definition of current operational value in ED 77. Those paragraphs express Mr Beardsworth’s view that the definition of current operational value should focus on the cost of replacing the asset (emphasis added):

AV7 In Mr. Beardsworth’s view, **current operational value should focus on the cost of replacing an asset using entry values** and an entity-specific perspective (where the outcome of adopting that perspective differs from the outcome of adopting a market participant’s perspective). This is because, in respect of operational assets, the asset’s **service potential is best represented by the cost the entity is currently required to incur in the marketplace at the measurement date to replace the asset.**

AV8 Mr. Beardsworth notes the importance of considering service potential when recognizing and measuring public sector assets (for example, see paragraphs 5.7 and 5.8 of the Conceptual Framework). ED 76 does not clearly state how the proposed definition of current operational value would reflect the service potential of an asset. His proposed definition would more clearly reflect the service potential of assets primarily held for operational capacity because it focuses on the cost of replacing an asset for its service potential.

AV9 He considers that there is a clear link between his view of current operational value and the measurement objective in the Conceptual Framework. **The cost of replacing the**

**service potential embodied in an asset gives users information about the current cost of replacing an asset used by an entity to provide services. That information is useful for both decision making and accountability when assets are held for their operational capacity.**

#### **Staff's view**

84. Staff concur with the Alternative View summarised in paragraph 78(b) and Mr Beardsworth's elaboration noted in ED 76 paras AV7–AV9, that the current value of an operational asset should be based on the cost currently required to replace the service potential embodied in the asset. Therefore, staff consider that the IPSASB's objective of current operational value measurements would best be met by the alternative definition of current operational value noted in paragraph 79 – that is, the cost to replace the service potential embodied in an asset at the measurement date.
85. As noted in paragraph 36 (about BC32–BC33 of ED 77), the IPSASB is of the view that the most relevant pieces of information to users regarding the current value of an operational asset are (emphasis added):
- (a) the **amount an entity would incur** at the measurement date to **replace the capacity to achieve its present service delivery objective** using its existing assets (staff consider that from a 'public investment' perspective, it also represents the cost currently avoided as a result of possessing the asset needed to provide future services); and
  - (b) the consumption of the asset (through depreciation), which is the amount the **entity would incur during the period** to provide the service at the prevailing prices when an asset is measured.
86. Staff consider that the cost approach to measuring current operational value described in ED 76 and ED 77 (which would measure the cost currently required to replace an asset used by an entity to provide services) would result in an appropriate current value measurement for operational assets. The depreciation based on this amount would reflect the current cost of consumption of the asset. Staff concur with ED 76 para. AV 9 that this information is useful for both decision making and accountability when assets are held for their operational capacity.
87. Current operational value is explicitly an entry value rather than an exit value. Therefore, staff consider that the reasons provided in IPSASB ED 76 and ED 77 (noted in paragraphs 15–16) for why neither 'current cost' in the IASB Revised Conceptual Framework nor 'replacement cost' in the existing IPSASB Conceptual Framework was proposed as an appropriate alternative to fair value for operational assets should be expanded to provide better justification for this proposed conclusion. [Section 4](#) below explores current cost and replacement cost.
88. The conclusion in paragraph 87 also reflects the staff view that the IPSASB's reasons for permitting the use of the income approach in measuring the current operational value of an operational asset, which is not primarily held to generate net cash inflows, should be expanded to provide better justification for that option.

### Question for the Board

Q5: Do Board members agree that its submission to the IPSASB should include the view that the IPSASB's objective for proposing current operational value as the current value measurement basis for operational assets would best be met by the alternative definition of current operational value in the Alternative View, paraphrased as the current cost of replacing the service potential embodied in the asset (paragraph 84)?

### Section 4: 'Current cost' and 'replacement cost' measurement bases as possible alternatives to fair value for measuring the current value of operational assets

89. As noted in paragraph 15, regarding the IASB's concept of current cost, the IPSASB indicated it prefers to see the value of an asset's **existing use** in delivering services depicted, rather than the **cost of an equivalent asset**. In respect an asset's existing use, staff noted in paragraph 66 that if the objective of current value measurement is to reflect the full service potential of an operational asset, then the measurement should be based on the highest and best use of the asset – that is, based on the use of the asset that would maximise the value of the asset.
90. Consistent with the Alternative View expressed by Mr Beardsworth in paragraph AV7 of ED 76 (quoted in paragraph 83), staff consider that the highest and best use of an operational asset is best represented by the 'the cost the entity is currently required to incur in the marketplace at the measurement date to replace the asset' (i.e. the current market buying price of an **equivalent asset** at the measurement date), notwithstanding that the NFP public sector entity does not intend to sell the asset or use it to generate a financial return.
91. Moreover, para. 6.41 of the IASB's Revised Conceptual Framework states that "... current cost provides information about the **cost of an asset consumed** ... That information can be used to **derive current margins** and can be used as **an input in predicting future margins** ... current cost **reflects prices prevailing at the time of consumption** ... When price changes are significant, margins based on current cost may be more useful for predicting future margins than margins based on historical cost." (emphasis added) Staff consider that, in the context of operational assets, 'margins' may be thought of as the extent to which the cost of services rendered during the period is recovered from the period's income (which may include user charges, rates, taxes, grants and appropriations). Therefore, measurement under current cost would likely provide the two pieces of information that the IPSASB consider most relevant to users regarding the current value of an operational asset described in paragraph 85 (that is, the amount an entity would incur to at the measurement date to replace the capacity to achieve its present service delivery objective, and the consumption of the asset).
92. The IPSASB's rationale for not supporting 'replacement cost' as a measurement basis (as noted in paragraph 16) – that current operational value is a more versatile measurement basis, as it can be applied to both specialised and non-specialised assets – implies replacement cost is inapplicable to assets valued using market techniques.<sup>11</sup> The IPSASB's rationale seems to regard replacement cost and market prices as mutually exclusive values, which staff do not support.

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11 ED 76 para. BC7.27 states that the current replacement cost of a **non-specialised asset** can be supported by **market-based measurement techniques** with similarities to market value; whereas, the current operational value of a **specialised asset** can be determined using **other measurement techniques**.

93. Staff consider that the notion of replacement cost (whether measured under the cost approach to fair value in AASB 13 or under another measurement basis) is derived solely from market transactions, some of which might not be observable in an active market (e.g. where a specialised asset would be replaced through a multitude of individual purchases of materials and labour).
94. In relation to the implication of ED 76 paragraph BC7.33 (quoted in paragraph 16) that replacement cost is inapplicable to assets valued using market techniques, it should be noted that the Working Guide for Statement of Accounting Practice SAP 1 *Current Cost Accounting* (Australian Accounting Research Foundation, 1984) reflects a different view. That Working Guide states that market prices, where available, are used to measure current cost. For example, it states that the current cost of vacant freehold land is its current market buying price based on the price per square metre of similar land in the vicinity (paragraphs 2671 – 2672) and that where items of plant and machinery with service potential very similar to existing plant and machinery are currently available in the market, their prices obtained from (for example) suppliers' price lists may be used to measure the existing items' current cost (paragraph 2621).
95. Therefore, staff consider that the notion of replacement cost (or current cost) is sufficiently robust to be applied to assets that are, or are not, traded in an active market. Staff observe that the IPSASB treating replacement cost as a measurement technique (i.e. the cost approach under current operational value) rather than a measurement principle (i.e. current cost under the IASB's RCF or replacement cost under its current Conceptual Framework) appears to have contributed to the mixed measurement principles noted in [Section 3.3.1](#), where the proposals suggest that an operational asset's service potential is measured using the income approach in some cases, which would be unlikely to result in a valuation reflecting the asset's service potential.
96. For the reasons in paragraphs 89–95, staff consider that the IPSASB's explanation of why neither 'current cost' in the IASB Revised Conceptual Framework nor 'replacement cost' in the existing IPSASB Conceptual Framework is an appropriate alternative to fair value as a current value measurement basis for operational assets should be expanded to provide better justification for this proposed conclusion.

#### **Question for the Board**

Q6: Do Board members agree that its submission to the IPSASB should include the view that the IPSASB's explanation in IPSASB ED 76 and ED 77 of why neither 'current cost' in the IASB Revised Conceptual Framework nor 'replacement cost' in the existing IPSASB Conceptual Framework is an appropriate alternative to fair value as a current value measurement basis for operational assets should be expanded to provide better justification for this proposed conclusion (paragraph 96)?