Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Fair Value Measurement for Not-For-Profit Entities**	**Meeting:**	February 2022 (M185)
Topic:	**Draft modifications to AASB 13 – Market participant assumptions**	**Date of this paper:**	7 February 2022
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		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Drafting Exposure Draft

Objectives of this paper

1. This paper considers the implementation guidance (IG) to be proposed in the forthcoming Exposure Draft (ED) regarding the market participant assumptions to use in measuring the fair value of not-for-profit (NFP) public sector entities' non-financial assets not held primarily for their ability to generate net cash inflows.

2. The objectives of this paper are for the Board to:

   (a) note the stakeholder feedback obtained through targeted outreach in December 2021 – January 2022;

   (b) note the work staff performed since the November 2021 meeting to address stakeholder feedback; and

   (c) **decide** what modifications to AASB 13 *Fair Value Measurement*, if any, to propose in the forthcoming Exposure Draft (ED).

Reasons for bringing this paper to the Board

3. At its November 2021 meeting, the Board considered a staff paper (Agenda Paper 3.2) that included draft IG on identifying the characteristics of market participants for, and the highest and best use of, specialised assets not held primarily for their ability to generate net cash inflows.[1]

1 Agenda Paper 3.2 for the November 2021 meeting used the phrase 'non-financial assets that are held primarily for their service capacity', which has the same meaning as the phrase 'non-financial assets that are not held primarily for their ability to generate net cash inflows'.

4. Staff prepared that draft guidance because, in stakeholder discussions and the responses received on ITC 45,[2] staff noted that the measurement issues stakeholders are commenting upon are related mainly to fair value measurement of specialised assets and not limited to restricted assets. Specifically, stakeholders requested guidance on:

   (a) identifying the highest and best use of specialised assets of the type described in paragraph 3;

   (b) the perspectives of market participants about various specialised assets, because stakeholders considered that many public sector entity assets are not sold in an active market; and

   (c) the implications of those perspectives for identifying the interest rates to apply in estimating the current replacement cost (CRC) of such specialised assets if borrowing costs are included in an asset's CRC.

5. However, stakeholder feedback received from targeted outreach in December 2021–January 2022 indicated that many stakeholders disagree that fair value guidance should be based on whether an asset is considered specialised (as noted in paragraphs A4–A6 in Appendix A).

6. Therefore, to assist Board members' deliberations on any modifications to AASB 13 to address the stakeholder requests noted in paragraph 4, this paper discusses an approach to provide guidance regarding market participant assumptions that is not based on whether an asset is specialised. Instead, staff recommend proposing guidance to clarify the application of the concept of "maximising the use of relevant observable inputs and minimising the use of unobservable inputs" in AASB 13 paragraph 61. In particular, staff recommend proposing implementation guidance on when:

   (a) the market selling price of an identical asset is not directly observable; and

   (b) only some relevant information about assumptions of market participants, other than the holder of the asset, is reasonably available.

   This is discussed in Section 2 of this paper.

7. At the February 2022 meeting, staff ask the Board to decide what modifications to AASB 13, if any, to propose in the forthcoming ED regarding the market participant assumptions used to measure the fair value of an NFP public sector entity's non-financial asset not held primarily for its ability to generate net cash inflows.

8. Agenda Paper 9.3 is a working draft ED, which includes draft implementation guidance and draft basis for conclusions paragraphs based on the approach the staff recommends, as discussed in Section 2 of this paper.

Structure of this paper

9. This paper is set out in three sections:

   - Section 1: Targeted outreach in December 2021–January 2022
   - Section 2: Approach recommended by staff regarding market participant assumptions
   - Section 3: Implications for borrowing costs
   - Appendix A: Summary of feedback from targeted outreach

2 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

- Appendix B: Extract from the 16 December 2021 staff paper used for targeted outreach (for the Board's information)

Section 1: Targeted outreach in December 2021–January 2022

10. Staff undertook the following outreach in December 2021–January 2022 regarding the draft modifications to AASB 13 contained in Agenda Paper 3.2 for the November 2021 meeting:

    (a) **Outreach step 1:** held a meeting with the Fair Value Project Advisory Panel (the Panel) on 1 December 2021, at which, due to time constraints, the discussion focused on the draft guidance concerning how to identify the market participant assumptions to use in fair value measurements;[3] and

    (b) **Outreach step 2:** Distributed a staff paper to targeted stakeholders on 16 December 2021,[4] which included:

        (i) draft IG on market participant assumptions, based on: (1) whether a market participant other than the holder of asset is readily identifiable; and (2) the entity likely to be the highest bidder for the asset in a hypothetical sale, and related draft illustrative examples (that draft IG and those draft illustrative examples are reproduced in Appendix B to this paper); and

        (ii) questions to stakeholders regarding the draft modifications to AASB 13 relating to the application of the cost approach contained in Agenda Paper 3.2 for the November 2021 meeting.

11. The targeted stakeholders who were invited to provide feedback on the 16 December 2021 staff paper were members of:

    (a) the Panel;

    (b) the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC); and

    (c) the Financial Reporting and Accounting Committee (FRAC) of the Australasian Council of Auditors General (ACAG).

12. A high-level summary of feedback received from the two targeted outreach steps in relation to market participant assumptions is contained in Appendix A for the Board's information.

13. Stakeholder feedback regarding the application of the cost approach, obtained in outreach step 2, is discussed in the working draft ED (Agenda Paper 9.3 for this meeting).

Overall feedback from stakeholders regarding market participant assumptions

14. Most Panel members who participated at the discussion at the 1 December 2021 Panel meeting disagreed with having guidance specifically for specialised assets. All 10 responding stakeholders who commented on this issue in the 16 December 2021 staff paper also disagreed with having guidance specifically for specialised assets (one stakeholder did not comment on this issue).

15. Six of the 11 stakeholders who commented on the 16 December 2021 staff paper (which explored developing guidance based on whether a market participant other than the holder of the asset is readily identifiable and on identifying the likely highest bidder for an asset) were concerned that:

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3 Agenda Paper 9.4 in the supplementary folder for this meeting is the minutes of the Panel meeting held on 1 December 2021

4 Agenda Paper 9.5 in the supplementary folder is a copy of the 16 December 2021 staff paper

(a) some assets might have multiple market participants, and requiring an entity to identify the likely highest bidder for an asset would impose greater costs in preparing and auditing financial statements; and

(b) it would be difficult to apply the concept of a hypothetical highest bidder for assets that are unlikely to be sold (e.g. because of a Government directive preventing an entity from selling the asset).

Section 2: Approach recommended by staff regarding market participant assumptions

16. In light of the comments noted in paragraphs 14–15 and in Appendix A, staff consider that any proposed modifications to AASB 13 relating to market participant assumptions should not be based on whether an asset is specialised, and:

(a) should attempt to align with the principles of AASB 13 as much as possible;

(b) for assets for which no relevant information about the market participant assumptions needed to estimate the fair value of the asset is reasonably available, should require the assumptions of the holder of the asset to be used in measuring the fair value of the asset, without also requiring the entity to consider whether other market participant assumptions exist. This would particularly apply to assets unique to government and (except for a hypothetical identical NFP public sector entity) unlikely to have another market participant; and

(c) the relief described in (b), which staff consider to be a more direct way of applying the requirements of AASB 13, should also be applied when considering the assumptions to use in estimating any borrowing costs to be included in an asset's CRC (if an entity chooses to include borrowing costs and other finance costs).

17. Accordingly, staff consider there would be merit in providing guidance that clarifies how to apply the concept of "maximising the use of relevant observable inputs and minimising the use of unobservable inputs" in AASB 13 paragraph 61. In particular, guidance would be useful for circumstances in which:

(a) the market selling price of an identical asset is not directly observable; and

(b) not all relevant information about assumptions of market participants, other than the holder of the asset, is reasonably available.

18. When developing proposed guidance that clarifies how the concept of "maximising the use of relevant observable inputs and minimising the use of unobservable inputs" should be applied, staff focused on the following paragraphs in AASB 13 (emphasis added) [explanation of the emphasised text is included in paragraphs 19–25]:

(a) AASB 13 paragraph 23: "In developing those assumptions [that market participants would use], **an entity need not identify specific market participants**. Rather, the entity shall **identify characteristics that distinguish market participants generally** …";

(b) AASB 13 paragraph 61: "An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, **maximising the use of relevant observable inputs and minimising the use of unobservable inputs.**"; and

(c) AASB 13 paragraph 89, regarding level 3 inputs: "An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. **In developing unobservable inputs, an entity may begin with its own data**, **but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants** (eg an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement."

Staff analysis

19. Staff note that paragraph 23 of AASB 13 states that an entity need not identify specific market participants, and the focus of fair value measurements is on the <u>assumptions</u> that market participants would use when pricing the asset (AASB 13 paragraph 22).

20. Staff note the stakeholder comment that many non-financial assets of NFP public sector entities not held primarily for their ability to generate net cash inflows are unique to the holder of the asset and another identifiable market participant for the asset would be unlikely to exist (that is, the entity would be unlikely to find observable inputs for measuring the fair value of those unique assets). Staff consider that the holder of those 'unique assets' (such as those assets listed in draft paragraph F7 in paragraph 27 below) would need to develop unobservable inputs in order to measure the fair value of those assets.

21. In this regard, staff consider that there would be merit in simplifying the principle in AASB 13 paragraph 89 (quoted in paragraph 18(c) above). AASB 13 paragraph 89 states that where unobservable inputs need to be developed, the entity's own data <u>may</u> be used as a starting point, in which cases it would be adjusted if reasonably available information indicates that other market participants would use different data. Staff recommend simplifying this principle so that NFP public sector entities would be <u>required</u> to use their own data as a starting point.

22. That is, the entity's own assumptions would be used as a starting point for measuring the fair value of assets where at least some unobservable inputs need to be developed (for assets for which market selling prices of identical assets are not directly observable), but the entity's own data would be adjusted based on different assumptions of other market participants that are reasonably available to the entity (and undertaking exhaustive efforts to identify those market participant assumptions would not be required). This would preclude an entity from using its own unadjusted data where those data are inconsistent with reasonably available information about the inputs that other market participants would use in pricing the asset.

23. Staff consider that the suggested simplification to AASB 13 paragraph 89 described in paragraphs 21–22 (as illustrated in paragraphs F3–F7 below paragraph 27) should reduce the potential for confusion regarding when the search for assumptions of other market participants ends, and in turn should reduce the cost and effort required to identify which market participant assumptions to use in measuring the fair value of non-financial assets of NFP public sector entities not held primarily for their ability to generate net cash inflows. This is because, under staff's recommended approach, the guidance would:

    (a) clarify that, if the market selling price of an identical asset is directly observable, that price would be used to measure the asset's fair value and the entity would not need to consider what assumptions market participants are using;

    (b) specify that, if relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, those assumptions would be used to measure the asset's fair value (albeit, in conjunction with the entity's own data, which would be the starting point where only some data of other market participants are reasonably available); and

    (c) specify that, if no relevant information about the assumptions of other market participants needed to estimate the fair value of the asset is reasonably available, the draft IG would not (as paragraph 89 currently does) require the entity to consider whether reasonably available information indicates that other market participants would use different data.

24. Therefore, in accordance with paragraphs 24(a)(iii) and 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*, staff consider there would be merit in simplifying AASB 13 paragraph 89 to avoid undue cost and effort required to identify the market participant assumptions to use in measuring such assets.

25. Staff consider that the approach described in paragraphs 21–22 (as illustrated in paragraphs F3–F7 below paragraph 27) would address the two main concerns stakeholders raised regarding the earlier approach explored in the 16 December 2021 staff paper noted in paragraph 15.

Draft authoritative implementation guidance

26. Instead of the draft guidance considered by the Board at its November 2021 meeting (which was based on whether an asset is specialised), staff propose for the Board's consideration the following draft authoritative implementation guidance to clarify how to apply the concept of "maximising the use of relevant observable inputs and minimising the use of unobservable inputs".

27. Paragraphs F3–F7 below are reflected in the working draft ED (Agenda Paper 9.3). Draft paragraphs BC22–BC35 in the Basis for Conclusions section of the working draft ED provide further elaboration of staff's rationale for those draft IG paragraphs.

Non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows

Market participant assumptions (paragraphs 22–23, 61 and 89)

F3 Paragraph 22 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. Paragraph 23 states that, in developing those assumptions, an entity need not identify specific market participants; and paragraph 89 states that (in relation to unobservable inputs for an asset) an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.

F4 For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows:

(a) if the market selling price of an identical asset is directly observable, that price (which incorporates implicitly the assumptions that market participants would use when pricing the asset, as referred to in paragraph 22) shall 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 explicitly estimates the pricing assumptions that market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

F5 For a non-financial asset of the type referred to in paragraph F4, in applying the principles in paragraphs 61, 89 and paragraph F4(b), to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:

(a) if all relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity shall use those assumptions in measuring the fair value of the asset. For example, the entity uses the observable market price of a comparable asset to measure the fair value of the asset subject to measurement, by adjusting for the differences between the comparable asset and the asset subject to measurement using relevant market data;

(b) if only some relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity (i.e. the holder of the asset subject to measurement) shall use its own assumptions as a starting point in measuring the fair value of the asset, and make adjustments to those assumptions if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (e.g. an entity-specific synergy); or

	(c) if no relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset.
F6	For the purposes of paragraph F5, exhaustive efforts need not be undertaken to identify whether relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available or whether the entity's own data should be adjusted.
F7	Examples of assets for which neither market selling prices are likely to be directly observable nor relevant information about different assumptions of other market participants is likely to be reasonably available include 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.

Section 3: Implications for borrowing costs

28. As noted in paragraph 4, some stakeholders requested guidance regarding the implications of market participant assumptions for identifying the interest rates to apply in estimating the CRC of non-financial assets of NFP public sector entities not held primarily for their ability to generate net cash inflows, if borrowing costs are included in such an asset's CRC.

29. Staff consider that, if the Board agrees with developing implementation guidance based on the approach recommended by staff, as described in paragraphs F3–F7 in Section 2 (that is, instead of proposing guidance based on whether an asset is specialised), specific guidance on borrowing costs and other finance costs would be unnecessary.

30. Under the approach recommended by staff, market participant assumptions about borrowing costs and other finance costs, if used in measuring the fair value of assets, should be:

    (a) based on whether the market selling price of an identical or comparable asset is directly observable. If so, the market approach should be applied, and the fair value measurements would be based on those market selling prices. Those prices would implicitly include any market participant assumptions regarding borrowing and finance costs. Therefore, applying the cost approach would be unnecessary and specific consideration of borrowing costs and other finance costs would be unnecessary; and

    (b) for assets for which the market selling price of an identical or comparable asset is not directly observable:

        (i) if all relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, including information about borrowing and other finance costs assumptions, the entity will use those assumptions in measuring the fair value of the asset; or

        (ii) if only some relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity's own data would be used as a starting point to determine whether, and how much, borrowing and other finance costs should be included in the asset's CRC. The entity would adjust those data for any reasonably available information about any different data used by other market participants relating to borrowing and other finance costs.

31. In relation to paragraph 30(a), regarding applying the market approach to measure an asset's fair value when the market selling price of a comparable asset is directly observable, staff note that paragraph F5(a) above (in paragraph 27) states that an entity would make adjustments to that market selling price for the differences between the comparable asset and the asset subject to measurement using relevant market data. However, staff consider that any such adjustments would exclude any explicit adjustments for borrowing costs or other finance costs because, as noted in paragraph 30(a):

    (a) the market selling price of the comparable asset would implicitly include any market participant assumptions regarding borrowing and finance costs; and

(b) borrowing costs and other finance costs considerations are only relevant when the cost approach is applied.

Questions for Board members

Q1: In relation to the ED's proposed guidance relating to market participant assumptions to use 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 Board members agree that the ED should propose implementation guidance based on the approach recommended by staff, as described in paragraphs F3–F7 below paragraph 27 in Section 2?

Q2: Subject to Board members' answer to Q1, do Board members agree that specific guidance on borrowing costs and other finance costs is unnecessary if the ED includes draft implementation guidance developed based on the approach recommended by staff, as described in Section 2?

Q3: If Board members agree with the approach recommended by staff, as described in Section 2, do Board members have any comments on the draft implementation guidance contained in draft paragraphs F3–F7 above?

Appendix A: Summary of feedback from targeted outreach

A1. This Appendix contains a high-level summary feedback from the two targeted outreach steps described in paragraph 10 of this paper.

Comments received from the Panel meeting held on 1 December 2021 (in respect of market participant assumptions)

A2. Agenda Paper 3.2 for the November 2021 meeting included the following draft description of a specialised asset (draft paragraph BC27 on page 14): "… a specialised asset typically has components modified to such an extent that observable market inputs of identical or comparable assets do not exist in an active market. It may also be a partially consumed asset for which only new asset prices are observable in an active market."

A3. At the 1 December 2021 Panel meeting, staff obtained feedback from the Panel regarding draft IG contained in Agenda Paper 3.2 of the November 2021 meeting. Specifically, feedback was obtained regarding:

(a) whether Panel members think fair value guidance regarding the characteristics of market participants for, and the highest and best use of, a specialised asset would be useful; and

(b) their views on the draft description of a specialised asset noted in paragraph A2 above.

A4. Most Panel members who commented on this topic disagreed with having guidance specifically for specialised assets (all 10 responding stakeholders who commented on this issue in the 16 December 2021 staff paper also disagreed with having guidance specifically for specialised assets). However, most of those stakeholders agreed with the following proposals noted in Agenda Paper 3.2 for the November 2021 meeting:

(a) in the absence of better information about the characteristics of market participants, the assumptions of the holder of the asset should be used in measuring the asset's fair value; and

(b) the asset's current use is presumed to be its highest and best use, unless there is evidence that, at the measurement date, the entity has committed to a plan to use the asset for an alternative purpose.

Those Panel members commented that those principles should not be based on whether an asset is considered specialised.

A5. When asked about the description of a specialised asset, Panel members did not reach a consensus. Mixed views were expressed regarding whether, for the purpose of fair value measurement, to base any description of a specialised asset either on whether:

(a) observable market inputs for identical or comparable assets exist in a market; or

(b) the asset only has a singular purpose.

A6. In addition, staff observed that there appear to be mixed views amongst Panel members regarding whether any public-sector-specific modifications to AASB 13 regarding market participant assumptions should be:

(a) principles-based and aligning to AASB 13 as much as possible; or

(b) more rules-based to reduce the amount of judgement required in fair value measurements.

Work performed between outreach step 1 and outreach step 2

A7. After reflecting on the comments received at the 1 December 2021 Panel meeting, staff explored a way to provide guidance on market participant assumptions that is not dependent on whether an asset is specialised.

A8. Staff considered that a key principle implicit in fair value measurements is that they are estimated based on the assumptions of the market participant most likely to be the highest bidder in a hypothetical sale of the asset subject to measurement. This principle is supported by the following related principles in AASB 13:

(a) AASB 13 paragraph 12 assumes that market participants (which Appendix A of AASB 13 defines as including buyers and sellers) act in their economic best interest; and

(b) AASB 13 paragraph 27 states that a fair value measurement takes into account the asset's highest and best use. That is, fair value measurement seeks to measure the maximum value that the asset can generate from the perspective of market participants.

A9. Accordingly, on 16 December 2021, staff distributed a paper to the targeted stakeholders noted in paragraph 11 that explored possible guidance on market participant assumptions based on whether a market participant other than the holder of the asset is readily identifiable, for all non-financial assets other than land (instead of basing it on whether an asset is specialised) and:

(a) if yes – the assumptions used in measuring the fair value of the asset are those of the market participant most likely to be the highest bidder in a hypothetical sale of the asset subject to measurement; or

(b) if no – the assumptions of the holder of the asset subject to measurement are used in measuring the fair value of the asset.

A10. Agenda Paper 9.5 for this meeting is a copy of that staff paper, which is included in the supplementary folder for the Board's information. For Board members' ease of reference, Appendix B to this paper includes an extract from that 16 December 2021 staff paper.

Stakeholder feedback on the 16 December 2021 staff paper

A11. Up to the date of completing this paper, 11 stakeholders from the target group mentioned in paragraph 11 provided feedback on the 16 December 2021 staff paper. Of them:

(a) 10 would prefer that the guidance is applicable to all non-financial assets (that are not held primarily for their ability to generate net cash inflows), rather than specialised assets (one did not comment on this issue);

(b) five expressed agreement that guidance should specify that the assumptions used in measuring the fair value of such assets are those of the market participant most likely to be the highest bidder in a hypothetical sale of the asset subject to measurement. However, six other stakeholders expressed concern that requiring an entity to consider the identity and/or characteristics of the likely highest bidder for an asset, especially given the low likelihood of the asset's sale, would create more complexity in fair value measurements and would impose greater costs in preparing and auditing financial statements;

(c) three considered that many such assets do not have market participants because they are unique and are not being held for sale, and thus it would be impractical to consider the identity and/or characteristics of the highest bidder for the asset in a hypothetical sale;

(d) 10 agreed that the assumptions of the holder of the asset should be used in measuring the fair value of the asset, if a market participant other than the holder of the asset is not readily identifiable (one did not comment on this issue);

(e) six agreed that specific guidance is not needed for measuring the fair value of land; but four commented that any guidance provided for other non-financial assets should in principle be applicable to land (one did not indicate whether specific guidance is needed for land). One of those four stakeholders would prefer the Board to consider mandating the use of the market approach in measuring fair value of all land of NFP public sector entities not held primarily for its ability to generate net cash inflows;

(f) 10 supported having guidance stating a general presumption that an asset's current use is its highest and best use (one did not comment on this general presumption). Eight of the 10 stakeholders agreed with the proposal that this presumption would be rebutted if the entity has 'committed' to a plan to use the asset for an alternative purpose; but two disagreed. Three of the 10 stakeholders indicated further clarification might be needed for identifying when such a commitment is made. Of the two stakeholders who disagreed with the proposed criterion for rebuttal, one disagreed because they consider being 'committed' to a plan to use the asset for an alternative purpose is too vague; the other stakeholder considered that the criterion is necessary but insufficient (i.e., the 'committed to' alternative use should only be applicable to surplus assets, and should only be considered a higher and better use if it can generate a comparable or higher exit price relative to the asset's current replacement cost); and

(g) nine agreed that if guidance is provided to assist NFP public sector entities to identify market participant assumptions to use in measuring fair value, there would not be a need for specific guidance regarding which entity's interest rate to use when measuring the finance costs to be included in an asset's CRC (if the cost approach is adopted and if an entity determines that finance costs should be included in the asset's CRC). Two stakeholders did not express a clear view on this issue. Of those nine stakeholders, two commented that the Board should consider giving guidance addressing their concerns about recognising a 'day-two' gain on the asset arising from any different treatment of borrowing costs between initial recognition and subsequent measurement. Specifically, the two stakeholders would like Accounting Standards to specify whether the fair value uplift should be recognised where an entity has chosen to expense borrowing costs at initial recognition under AASB 123 *Borrowing Costs* and subsequently measured the asset's fair value (on 'day two') applying the cost approach and decided to include borrowing costs in that fair value measurement.

Appendix B: Extract from the 16 December 2021 staff paper

B1. This Appendix includes an extract from the 16 December 2021 staff paper used in the targeted outreach described in paragraphs 10(b) and 11 of this paper.

B2. The draft implementation guidance and illustrative examples relating to market participant assumptions included in the 16 December 2021 staff paper are reproduced below.

Non-financial assets (except land) of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows (paragraphs 22–23)

F3 Paragraphs F4–F11 do not apply to land.

Market participant assumptions

F4 The assumptions used in measuring the fair value of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows are those of the market participant (including for-profit and other not-for-profit public sector entities) most likely to be the highest bidder in a hypothetical sale of the not-for-profit public sector entity's asset subject to measurement.

F5 For a non-financial asset not held primarily for its ability to generate net cash inflows, a not-for-profit public sector entity applies judgement in determining:

(a) whether another market participant other than the holder of the asset (including private sector entities, for-profit public sector entities and other not-for-profit public sector entities) is readily identifiable; and

(b) if so, which market participant is most likely to be the highest bidder in a hypothetical sale of the not-for-profit public sector entity's asset subject to measurement.

F6 Notwithstanding paragraphs F4 and F5, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, if another market participant is not readily identifiable, the assumptions of the holder of the asset subject to measurement are used in measuring the fair value of the asset.

Considering whether private sector market participants exist for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows

F7 In respect of paragraph F5(a), a private sector market participant for such an asset is assumed not to be readily identifiable if it is reasonable to expect that there would not be a private sector entity willing to purchase the not-for-profit public sector entity's asset subject to measurement in a hypothetical sale. Examples of assets for which a private sector market participant typically is not readily identifiable are defence weapon platforms, infrastructure (e.g. roads, drainage and sewerage works), prisons, parliament houses, embassies, court houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, community buildings and facilities (e.g. toilet blocks) and library resources.

F8 In respect of paragraph F5(b), where private sector entities hold and operate similar assets to provide similar services to those of the not-for-profit public sector entity's asset subject to measurement, such as a school, hospital or aged care facility, those private sector entities would also be considered a market participant for the not-for-profit public sector entity's asset. In these circumstances, the holder of the not-for-profit public sector entity's asset subject to measurement applies judgment in determining whether one of those private sector entities or other public sector entities is likely to be the highest bidder in a hypothetical sale of the asset subject to measurement.

F9 Appendix A defines market participants as 'buyers and sellers' in the principal or most advantageous market for the asset that have particular characteristics. Sometimes a not-for-profit public sector entity may contract a private sector entity to construct a non-financial asset on its behalf (such as in a public-private partnership or a service concession arrangement). Such a private sector entity would be considered a market participant for the not-for-profit public sector entity's asset only if it is reasonable to expect that the private sector entity would hold a similar asset to generate economic benefits for itself separately from an arrangement to construct or to operate similar assets on behalf of a public sector entity. That is, the private sector entity would be unlikely to be a potential buyer of the public sector entity's asset and would be acting only as a service provider for the not-for-profit public sector entity.

Highest and best use of a non-financial asset not held primarily for its

ability to generate net cash inflows

F10 In respect of paragraph 28(c), for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, a use is financially feasible if market participants (including not-for-profit 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.

F11 Paragraph 29 states that an entity's current use of a non-financial asset is presumed to be its highest and best use, unless market or other factors suggest that a different use by market participants would maximise the value of the asset. For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the presumption that the asset's current use is its highest and best use is rebutted when, and only when, at the measurement date:

(a) for an asset for which another market participant other than the holder of the asset is readily identifiable, an alternative use by a market participant is feasible, taking into account the use of the asset that is physically possible, legally permissible and financially feasible for the market participant in the context of the current social-political environment, as well as the likelihood that any legal restrictions will change; or

(b) for an asset for which another market participant is not readily identifiable, the holder of the asset, or the Government to which it belongs, has committed to a plan to use the asset for an alternative purpose

Australian illustrative examples for not-for-profit public sector entities

These illustrative examples accompany, but are not part of, AASB 13. They illustrate aspects of the Australian guidance for not-for-profit public sector entities in AASB 13, but are not intended to provide interpretative guidance.

These examples illustrating aspects of the Australian guidance for not-for-profit public sector entities in AASB 13 complement, and have the same status as, the Illustrative Examples accompanying IFRS 13 Fair Value Measurement*, which are available on the AASB website to website users in Australia.*

IE1 The following examples portray hypothetical situations. They are intended to illustrate how a not-for-profit public sector entity might apply some requirements of AASB 13 *Fair Value Measurement* to particular types of assets, on the basis of the limited facts presented. Although some aspects of the examples might be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying AASB 13. The evaluations in each example are not intended to represent the only manner in which AASB 13 could be applied.

Market participants assumptions for and highest and best use of an asset not held primarily for its ability to generate net cash inflows

IE2 Examples 1 and 2 illustrate the application of paragraphs F4–F11.

Example 1 – A prison constructed by a private sector entity

Entity A is a for-profit private sector entity. Entity A constructed a prison building on behalf of Government B. As part of the arrangement, Entity A will operate the prison for 20 years. Government B pays for the services Entity A provides. There is no other Government or other public sector entities that would provide similar corrective services in the jurisdiction as Government B.

Government B recognises the prison building as an asset and subsequently measures it at fair value. As at the measurement date, Government B has not committed to a plan to use the prison for an alternative purpose.

Government B determines that the arrangement is not within the scope of AASB 1059 *Service Concession Arrangements: Grantors*.

<u>Market participant assumptions</u>
It is expected that Entity A would not hold and operate a prison separately from an arrangement with a public sector entity this is because a prison does not generate a commercial return. Other than a public sector entity providing corrective services, no entity would be willing to pay for the cost of the services provided by a prison. Therefore, Government B determines that there would not be a private sector market

participant (including Entity A) that would be willing to buy its prison building in a hypothetical sale.

In addition, since there is no other Government or other public sector entity that would provide similar corrective services as Government B in the jurisdiction, the market participant assumptions used for measuring the fair value of the prison building are Government B's assumptions.

Highest and best use
In accordance with paragraph F100(b), the current use of the building as a prison is presumed to be the building's highest and best use, since Government B has not committed to a plan to use the prison building for an alternative purpose.

Example 2 – A public hospital constructed by a private sector entity

Entity C is a for-profit private sector entity in the business of constructing and operating hospitals for different entities in both the private and public sectors. Entity C constructed a hospital on behalf of Government D and will operate the hospital as a public hospital for 20 years. Government D pays for the health services Entity C provides to the public.

Government D is subject to legislation preventing it from charging patients with Medicare cards the market rate of relevant health services that a private hospital would be able to charge.

Government D determines that the arrangement is not within the scope of AASB 1059 *Service Concession Arrangements: Grantors*.

Government D recognises the hospital building as an asset and subsequently measures it at fair value. As at the measurement date, there are no market or other factors suggesting that a different use than the current use would maximise the value of the hospital building to any market participant.

Market participant assumptions
Since Entity C is in the business of constructing and operating hospitals also for private sector entities, it would be reasonable to expect that it would hold and operate a hospital separately from an arrangement with a public sector entity. Therefore, Entity C is considered a market participant for Government D's hospital building as at the measurement date.

Government D applies judgement in determining whether Entity C, another similar private sector entity or a public sector entity with similar health services delivery objectives is likely to be the highest bidder in a hypothetical sale of the hospital building. Because a for-profit private sector entity would be able to charge market prices for providing health services to generate a commercial return, Government D determines that a for-profit private sector entity would be likely to be the highest bidder in a hypothetical sale for Government D's hospital building when competing with not-for-profit health service providers. Therefore, Government D uses for-profit private sector entity assumptions in measuring the fair value of the hospital building.

Highest and best use for the hospital
Since there are no market or other factors suggesting that a different use than the current use would maximise the value of the hospital building to any market participant, in accordance with paragraph F11(a), the current use as a hospital is presumed to be the hospital building's highest and best use.

Valuation techniques
Since a for-profit private sector entity would be likely to consider the hospital building's cash-generating ability in pricing the building, Government D applies judgement in determining whether the income approach or the cost approach (or a combination of approaches) would be the most appropriate valuation technique to apply in the circumstances, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Restriction on pricing
The restriction imposed on Government D by the legislation preventing it from charging Medicare patients the market rate of those health services is considered to be an entity-specific restriction that would not be transferred to a market participant upon sale of the hospital building. In a hypothetical sale, a market participant such as Entity C (a private sector entity) would not be subject to the pricing restriction specified in the legislation affecting Government D. Therefore, the restriction on pricing would not be considered when estimating the fair value of the hospital building.