Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**IPSASB Exposure Drafts on Public Sector Measurement**	**Meeting:**	AASB September 2021 (M183)
Topic:	**Summary of stakeholder feedback**	**Date of this paper:**	23 August 2021
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		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider comments on ITC 45 and decide comments on IPSASB proposals

Objective of this paper

1. The objective of this paper is for the Board to **consider** stakeholder feedback about fair value and the IPSASB's proposed current operational value (COV) measurement basis, for the purpose of deciding the comments to make to the IPSASB on the following Exposure Drafts:

   (a) ED 76 *Conceptual Framework Update: Chapter 7,* Measurement of Assets and Liabilities in Financial Statements; and

   (b) ED 77 Measurement.

High-level overview of stakeholder feedback on ITC 45 and fair value measurement

2. The Board added 22 AASB Specific Matters for Comment (SMCs) on 11 topics in 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*.

3. Those topics and AASB SMCs were related to the current value measurement of operational capacity assets[1] and focused on fair value and COV.

4. As at the date of this paper, the Board received five comment letters on ITC 45. Appendix A contains a list of respondents. These respondents provided feedback on most AASB SMCs and did not comment on the IPSASB SMCs.

5. In addition to incorporating the Board's tentative decisions at its June 2021 and August 2021 meetings, the working draft submission (Agenda Paper 13.3) reflects staff recommendations

1 For ease of reference in this agenda item, staff have used the term 'operational capacity assets' as an abbreviation for the phrase used in ED 76 and ED 77 – 'non-financial assets held for their operational capacity'. This phrase has the same meaning as the following phrase used in AASB Standards (e.g. AASB 136 para. Aus5.1) – non-financial assets of a not-for-profit public sector entity 'not held primarily for their ability to generate net cash inflows'.

based on the analysis of the stakeholder feedback received on fair value and COV to date. Table 1 below provides a high-level summary of that feedback. It includes feedback about:

(a) ITC 45 (regarding fair value and COV), which includes comments from:

(i) the five comment letters (summarised in Appendix B of this paper);

(ii) oral feedback received at the meeting with the Fair Value Measurement Panel (the Panel) held on 29 June 2021 and the virtual outreach event held on 6 July 2021 (summarised in Appendix C of this paper and Appendix B of Agenda Paper 5.1 for the August 2021 meeting considered by the Board); and

(iii) oral feedback received at meetings with the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) and the Financial Reporting and Accounting Committee (FRAC) of the Australasian Council of Auditors-General (ACAG); and

(b) fair value measurement obtained during the Board's Fair Value Measurement for Not-for-Profit Entities project (FVM project) in 2019-21, which includes:

(i) the targeted outreach throughout 2019-21 as part of the FVM project to date. This includes comments from the meetings of the Panel held on 16 May 2018, 10 April 2019,[2] 10 February 2020[3] and 14 August 2020.[4] It also includes letters received from: three valuers (the two non-confidential letters are Agenda Papers 6.4 and 6.5 for the November 2019 meeting); ACAG (see Agenda Paper 6.6 for the November 2019 meeting); and HoTARAC (see Agenda Paper 11.3 for the March 2020 meeting);

(ii) the 2020 targeted outreach discussions with some users of public sector entities' financial statements regarding the current value measurement perspective most useful to them, and on the previously tentatively-proposed additional disclosures regarding restricted land (see Agenda Paper 4.2 for the November 2020 meeting); and

(iii) the 2021 survey sent to members of the Panel and stakeholders who originally requested guidance to assist Not-for-Profit (NFP) public sector entities in applying AASB 13 (see Agenda Paper 10.3 for the February 2021 meeting). The purpose of that survey was to understand whether circumstances and the scope of guidance sought have changed since those stakeholders originally requested guidance, and the specific aspects of fair value measurement for which guidance is most promptly needed.

6. Table 1 is structured around the 11 topics in ITC 45, which correspond to the subheadings used in the working draft submission (Agenda Paper 13.3). References to a 'majority view' relate to the majority of those who commented on the issue, and not necessarily the majority of stakeholders consulted.

2 Agenda Paper 8.1 for the April 2019 meeting contains a high-level summary of feedback from Panel members at its 16 May 2018 and 10 April 2019 meetings.

3 Appendix A of Agenda Paper 11.1 for the March 2020 meeting includes a high-level summary of feedback received from Panel members at its 10 February 2020 meeting.

4 Agenda Paper 7.2 for the September 2020 meeting is a copy of the staff paper for the Panel meeting held on 14 August 2020, annotated with a summary of feedback received from stakeholders.

Table 1: High-level summary of stakeholder feedback

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Topic A: The measurement basis to apply when measuring the current value of an operational capacity asset

Topic K: Overall comments on the IPSASB's proposed COV measurement basis

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Feedback received in the five comment letters on ITC 45

- Four of the five respondents consider that fair value is appropriate for measuring the current value of operational capacity assets, whether restricted or unrestricted. They:
    - would not support applying COV in Australia;
    - consider that the 'highest and best use' and 'maximise the use of market participant data'[5] concepts in fair value should be retained for NFP entities. The highest and best use of an asset should take into account the use of the asset that is physically possible, legally permissible and financially feasible; and
    - consider that the existing use is the only possible use of most specialised operational capacity assets. Therefore, the current use of those assets should be assumed to be their highest and best use, unless there is evidence to suggest otherwise[6].
- Of these four respondents who support fair value:
    - three consider that it is appropriate to apply AASB 13 as it is currently applied; and
    - one considers that it is appropriate to apply fair value by incorporating the AASB's tentative view (as stated in ITC 45) to measure restricted operational capacity land at the market price of equivalent unrestricted land (under certain circumstances).
- Of these four respondents who support fair value, two agree and two partially agree that hypothetical market participant buyers would include another NFP entity with similar service delivery objectives.
- One respondent prefers measuring operational capacity assets at depreciated replacement cost. This respondent considers that, in many cases, the current use of local government assets is their highest and best use.

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Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix B of Agenda Paper 5.1 for the August 2021 meeting)

- A majority of those who commented would prefer for the Board to retain fair value (with its three valuation techniques being the market, income and cost approach) and continue its work on clarifying the requirements of AASB 13 (e.g. identifying the market participant for an asset and what they would do with the asset) for NFP entities.

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5 As commented on in page 5 of HoTARAC's submission, the phrase "maximise the use of market participant data" used in IPSASB ED 76 differs slightly from the words used in IFRS 13 (and AASB 13). Para. 61 of IFRS 13/AASB 13 refers to "maximising the use of relevant observable inputs".

6 This is consistent with para. 29 of IFRS 13/AASB 13.

Topic B: Definition of 'current operational value'
Feedback received in the five comment letters on ITC 45 Of the five respondents who commented on this topic: • three disagree with COV and thus do not support either definition of COV in the EDs; and • two support the Alternative View that current value measurement of operational capacity assets should focus on each asset's replacement cost.
Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix B of Agenda Paper 5.1 for the August 2021 meeting) • A majority of those who commented disagree with the ED 77 assumption of existing use value, and supported the concept of 'highest and best use'. However, a majority also prefer fair value to COV, hence the view was not confined to how COV should be measured.
Topic C: Measurement techniques for estimating the COV of an operational capacity asset – relevance of using the income approach
Feedback received in the five comment letters on ITC 45 Of the four respondents who commented on this topic: • three agree with the ED 77 proposal that the income approach should be permitted; and • one disagrees with the ED 77 proposal that the income approach should be permitted.
Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix B of Agenda Paper 5.1 for the August 2021 meeting) • A majority of those who commented agree with permitting use of the income approach to measure the current value of an operational capacity asset.
Topic D: Measuring the current value of an operational capacity asset based on its current use
Feedback received in the five comment letters on ITC 45 None of the respondents commented directly on whether they support the IPSASB's view that an asset's COV should be measured based on its current use, disregarding potential alternative uses and any other characteristics of the asset that could maximise its market value. The respondents expressed views about fair value. Of the four respondents who commented on this SMC: • all consider that, for specialised assets or restricted assets, the asset's current use is its highest and best use in most cases; and • three commented on 'reinvestment potential': two of them consider that reinvestment potential is only relevant for surplus assets intended to be sold.
Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix B of Agenda Paper 5.1 for the August 2021 meeting) • Panel members and commentators did not comment directly on whether they support the IPSASB's view that an asset's COV should be measured based on its current use, disregarding potential alternative uses and any other characteristics of the asset that could maximise its market value. These stakeholders expressed views about fair value. • The majority support measuring the current value of operational capacity assets at fair value based on their highest and best use. They consider that, for specialised assets or restricted assets, the asset's current use is its highest and best use in most cases.

Topic E: Measuring the current value of restricted operational capacity assets
Feedback received in the five comment letters on ITC 45 Of the four respondents who commented directly on this topic: • three disagree that the fair value of restricted assets should be measured without a reduction for the restrictions; and • one agrees that the fair value of restricted assets should be measured without a reduction for the restrictions One respondent did not comment on this topic directly. However, it expressed the view that buildings in good condition, on land with redevelopment potential and utilised for a local government specialised function, should not be valued at nil or a very low amount. They disagree that the fair value of such buildings should be measured assuming a hypothetical buyer would not attribute a value to the buildings because they would be likely to demolish the existing buildings to make way for new buildings to achieve a hypothetical highest and best use (see paragraphs 7–12 below).
Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix B of Agenda Paper 5.1 for the August 2021 meeting) A majority of Panel members and virtual event participants who commented disagree that, in respect of restricted land and restricted improvements on land, fair value should be measured without a reduction for the restrictions. However, most of these stakeholders also commented that restricted improvements are measured at their current replacement cost, which is unaffected by the restrictions.
FVM project 2019-21 feedback • A majority of respondents confirmed that the fair value of specialised buildings is measured at current replacement cost, but the fair value of restricted land is measured based on market prices reflecting the restrictions. • A majority of respondents consider that restricted land should not be valued based on the value of equivalent unrestricted land.
Topic F: Assumed location of an operational capacity asset used to measure its current value
Feedback received in the five comment letters on ITC 45 All four respondents who commented on this topic agree that an asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location.
Feedback received from the 29 June 2021 Panel meeting and the virtual outreach event (Appendix C of this paper) A majority of those who commented agreed with the IPSASB's proposed 'existing location' assumption.
FVM project 2019-21 feedback A majority of respondents consider that an asset's current value measurement should assume that the entity will continue to meet its service delivery objectives from the same location.

Topic G: Nature of the component costs to include when considering the cost of a modern equivalent asset
Feedback received in the five comment letters on ITC 45 Of the three respondents who commented on this topic, two respondents commented that the IPSASB's proposal (to exclude certain costs in some circumstances) and the AASB's tentative view (that all necessary costs intrinsically linked to acquiring or replacing an asset should be included) are not mutually exclusive. One of them commented that, under the IPSASB's proposals, the costs that are excluded relate to costs associated with enhancing the asset from its current size and specification. One other respondent agrees with the AASB's tentative view.
Feedback received from the 29 June 2021 Panel meeting (Appendix C of this paper) A majority of Panel members who commented: • agree with the need for an overarching principle for which costs to include (which is similar to the AASB's tentative view that all necessary costs intrinsically linked to acquiring or replacing an asset at the measurement date should be included); but • also agree with some of the proposals in IPSASB ED 77 para. B35 that certain one-off costs should be excluded from the measurement of current replacement cost. Their main concern was the lack of a conceptual approach to the identification of relevant costs in IPSASB ED 77.
FVM project 2019-21 feedback A majority of stakeholders consider that a Standard should set out an overarching principle for measuring current replacement cost. Three views were debated with practitioners regarding the current replacement cost (CRC) of a self-constructed asset: • View 1 – CRC should be estimated by assuming that the asset does not presently exist and needs to be replaced from scratch; and therefore should include current estimates of costs based on the conditions that existed when the asset was initially constructed. Costs of repairing damage to other facilities caused by replacing the asset should be excluded from the CRC if those facilities did not exist when the asset was initially constructed; • View 2 – the CRC should exclude any components of the asset that will not require replacement in the future because their service potential does not expire over time; and • View 3 – the CRC should include current estimates of costs on the assumption that the asset does not presently exist, and should reflect the conditions existing at the measurement date. CRC should include the costs of repairing damage to other facilities if those facilities exist at the measurement date.
This issue was not discussed at the virtual outreach event.

Topic H: Whether borrowing costs should be included when considering the cost of a modern equivalent asset
Feedback received in the five comment letters on ITC 45 Of the three respondents who commented on this topic: • one respondent and the majority of HoTARAC members agree with the AASB's tentative view that the accounting policy choice regarding whether to capitalise borrowing costs into an asset's cost on initial recognition is irrelevant to how those costs should be treated when measuring the current value of the asset; and • one other respondent and two HoTARAC members agree with the IPSASB's proposal that, if an entity does not capitalise borrowing costs in accordance with its accounting policy, the entity should disregard any financing costs.
Feedback received from the 29 June 2021 Panel meeting (Appendix C of this paper) A majority view of Panel members was not discerned in relation to the borrowing cost issue; mixed views were expressed. Some Panel members commented that, in principle, borrowing costs should be included in the measurement of an operational capacity asset's current value, but also that borrowing costs typically would be immaterial, except in relation to some infrastructure assets.
FVM project 2019-21 feedback The Board received mixed views on this topic during its FVM project. Some stakeholders consider that an NFP public sector entity should be required to exclude borrowing costs from the current replacement cost of a self-constructed asset if that entity elects, under paragraph Aus8.1 of AASB 123 *Borrowing Costs*, not to capitalise borrowing costs into the cost of qualifying asset. Their reasons include that: (a) under Government Finance Statistics, borrowing costs are not capitalised into the cost of qualifying assets; (b) CRC is, in principle, a current measure of the costs capitalised into an asset on initial recognition; (c) some NFP entities self-construct assets without borrowing; and (d) due to the complexity of funding arrangements in the public sector, identifying borrowing costs attributable to particular self-constructed assets would be complex, costly and unreliable. However, other stakeholders consider that borrowing costs should always be included. Their reasons include that: (a) market participant sellers of an asset constructed over a period of time would demand a return on the capital (debt and equity) tied up in that asset during the construction period, and market participant buyers would be prepared to compensate the seller because they would need to incur finance costs if they self-constructed the asset; (b) the price that market participants would be prepared to pay for an asset is unaffected by accounting policies adopted in respect of that asset; and (c) International Valuation Standard IVS 105 *Valuation Approaches and Methods* (para. 70.11) states that the fair value of property, plant and equipment measured under the cost approach includes "finance costs (eg. interest on debt financing) and … profit margin/entrepreneurial profit to the creator of the asset …".

This issue was not discussed at the virtual outreach event.

Topic I: Consideration of surplus capacity and economic obsolescence

Feedback received in the five comment letters on ITC 45

All three respondents who commented on this topic:

- disagree with the IPSASB's proposal that current value measurement should assume, in all cases, that the asset is being used to its full capacity; and
- disagree, or only conditionally agree, with the Alternative View that the severable part of the asset should be bifurcated and measured as an asset held for its financial capacity under fair value. Two of these respondents conditionally agree in the sense that they consider that surplus capacity should only be bifurcated if the entity plans to dispose of that capacity.

FVM project 2019-21 feedback

The questions about whether current value measurement should assume that the asset is being used to its full capacity or whether a severable surplus part of the asset should be bifurcated and measured as a separate asset were not discussed with stakeholders during the FVM project (these issues arose from IPSASB ED 77).

During the FVM project, most stakeholders expressed support for the AASB's tentative view that, when measuring an asset's current replacement cost under fair value, economic obsolescence should not:

(a) be identified if the asset has apparent 'excess capacity' that is temporary or occurs cyclically; and

(b) be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity.

This issue was not discussed at the 29 June 2021 Panel meeting or the virtual outreach event.

Topic J: Whether to identify value in use as a measurement basis in the IPSASB's updated Conceptual Framework

Feedback received in the five comment letters on ITC 45

Of the three respondents who commented on this topic, two agree and one disagrees with the proposed removal of value in use from the list of measurement bases in the IPSASB Conceptual Framework.

This issue was not discussed at the 29 June 2021 Panel meeting or the virtual outreach event.

Fair value of specialised buildings

7. Amongst other measurement issues, much of the focus of the Board's discussion to date has been on the fair value measurement of restricted land and specialised buildings on restricted land. The feedback from a majority of stakeholders is that the fair value of restricted land is being measured at a reduced value market price (to reflect the restriction), whereas the fair value of specialised buildings is being measured at the building's current replacement cost.

8. However, in its comment letter on ITC 45, the South Australian Local Government Financial Management Group (SALGFMG), which represents over 95 per cent of all local governments in South Australia, expressed concerns that some buildings held by local governments are being measured at nil or at a very low amount. This in turn means that nil or a very low amount of depreciation is being recognised for such buildings. The SALGFMG considers that this does not faithfully represent the local government's expenses.

9. SALGFMG explained in its letter that a nil value sometimes is attributed to buildings specialised for a local-government-specific function (e.g. council civic buildings) because some valuers and auditors conclude that a market participant buyer would consider that the existing council building needs to be demolished to make way for a new building to achieve a hypothetical highest and best use.

10. The comment letter on ITC 45 from another stakeholder (the Australian Property Institute (API)) includes an example of a public school situated on residential zoned land. The example assumes that, due to a demographic change, demand for the public school has declined. Because a valuer would value land and buildings jointly, and the highest and best use to a market participant buyer is residential development, a market participant would attribute a nil or negative value to the school building. The market value for the site would be entirely attributable to the land as a residential development site. A similar comment was made in the comment letter from APV Valuers & Asset Management, regarding AASB SMC 3 (using the example of hospital buildings used only for storage).

11. The SALGFMG disagrees with the view that specialised buildings on 'community land' would have a higher and better use than the existing local-government-specific function. This is because, under the *Local Government Act 1999*, a local council is not permitted to dispose of community land or use community land for a business purpose (unless the classification as community land is revoked).

12. In conversations with HoTARAC and representatives of some Valuer General offices, it appears that the fair value of specialised buildings of most Federal, State or Territory public sector entities is measured at CRC and not at a nil value. Based on limited input received on this matter, it appears that this concern might be limited to local governments, and possibly only in some jurisdictions. Staff intend to consider this matter and report back to the Board at a future meeting as part of the Board's FVM project.

Structure of this paper

13. There are no questions for Board members in this paper.

14. This paper contains three appendices for the Board's information:

- Appendix A contains a list of respondents on ITC 45.
- Appendix B includes a summary of comments in the five comment letters on ITC 45.
- Appendix C includes a high-level summary of comments received from the 29 June 2021 Panel discussion and the virtual outreach event on the measurement topics to be deliberated by the Board at this meeting (complementing Appendix B of Agenda Paper 5.1 for the August 2021 Board meeting).

Appendix A: List of respondents on ITC 45

The Board received 5 comment letters on ITC 45.

Submission no.	Respondent	Stakeholder group
S1–APV	APV Valuers & Asset Management	Valuer
S2–API	Australian Property Institute	Valuer
S3–SALGFMG	South Australian Local Government Financial Management Group	Financial statements preparers
S4–HoTARAC	Heads of Treasuries Accounting and Reporting Advisory Committee	Financial statements preparers
S5–ABS	Australian Bureau of Statistics	Compilers/users of financial data

Appendix B: Summary of comment letters received on ITC 45

Some AASB SMCs (SMC 4, 20, 21 and 22) are unrelated to the Board's submission to the IPSASB; therefore, a summary of comments on those AASB SMCs is not included in this paper. That summary of comments will be provided for the Board's consideration at the November 2021 meeting together with other comments raised by respondents about other possible measurement topics the Board could consider in its FVM project.

The summary of responses below involves editing of the comments received. Where a respondent's comments did not identify a specific SMC, staff used judgement to allocate the comments to the most relevant topic below. The comment letters can be accessed via the AASB website and are included in the supplementary folder for the Board's reference.

Responses in Topics A and K have been combined because of the overlapping nature of the two topics.

Topic A The measurement basis to apply when measuring the current value of an operational capacity asset

Topic K Overall comments on the IPSASB's proposed COV measurement basis

[Corresponds to ED 76 SMC 3, see Agenda Paper 13.3 paragraphs 32–37]

AASB SMC 1 **AASB SMC 3**	**In respect of the measurement basis to apply when measuring the current value of an operational capacity asset, do you agree with the IPSASB's proposal that fair value is inappropriate because the following concepts are generally inappropriate for NFP public sector entities:** **(a) 'highest and best use'; and** **(b) 'maximise the use of market participant data'?**
AASB SMC 18	**For NFP entities in Australia, do you support measuring the current value of <u>restricted</u> operational capacity assets using:** **(a) the COV measurement basis; or** **(b) fair value as currently applied under AASB 13; or** **(c) fair value incorporating the AASB's tentative views?**
AASB SMC 19	**For NFP entities in Australia, do you support measuring the current value of <u>unrestricted</u> operational capacity assets using:** **(a) the COV measurement basis; or** **(b) fair value as currently applied under AASB 13; or** **(c) fair value incorporating the AASB's tentative views?**

S1–APV: Supports fair value (incorporating the AASB's tentative views) and COV

- It seems that the only difference between fair value and COV is that fair value is based on an 'exit price at highest and best use' whereas COV is based on an 'entity specific entry price'. In practice, the valuation under both bases is likely to be the same, unless an asset's current use is not its highest and best use.
- There would be no impediment to possibly changing practice if the AASB's tentative decisions to date in its FVM project (where different from current practice) were to come into effect.
- It would be very rare that a public sector asset is not being used for its highest and best use. This is because most public sector assets are specialised and built specifically to deliver

services to the community (such as specialised buildings and key infrastructure), and thus these assets are being used for their highest and best use. If such a rare case occurs, APV considers that the asset's current value should be based on the asset's highest and best use.

- For specialised buildings (court houses, hospitals, admin centres, depots, universities, etc.) the highest and best use will always be what the asset is currently be used for, unless it is now being grossly underutilised. For example, hospital services have now moved to a new hospital and the old hospital building is now being used for storage. The old building would now be valued to reflect the difference in utility between the existing building (hospital design) and the modern equivalent building (storage). Due to the specialised nature of the building, the land is most likely to hold the bulk of the property value. Due to the specialised nature of the building design, it would be unlikely to be of a material value.
- To ensure more consistent understanding of the requirements and application of AASB 13, the AASB should develop worked examples detailing the process and steps involved in determining fair value (and their subsequent depreciation) for specialised public sector assets.
- APV considers the community would be better served by requiring public sector entities to disclose information about assets when they are not being used at their highest and best use. This is because the inefficient use of such assets represents an opportunity cost to the community and governments should be made accountable for that inefficient use of resources. APV recommends that the AASB considers including this disclosure requirement even if the IPSASB's proposals were to be adopted in Australia.

S2–API: Supports fair value as currently applied under AASB 13

- AASB 13 provides a conceptually sound approach to measuring fair value. AASB 13 anticipates three valuation approaches that are widely applied by valuers.
- API believes that fair value derived from each of the three valuation approaches should theoretically be the same.
- Fair value based on exit price provides a consistent measurement basis for all assets including restricted assets in the public sector. The 'highest and best use' and 'maximising the use of market participant data' concepts should be retained for NFP entities.
- There is no evidence that using measures other than fair value would benefit users of financial statements. Sector neutrality through the adoption of IASB Standards is a strength. API and its members do not support a departure from IFRS 13/AASB 13.

S3–SALGFMG: Supports using depreciated replacement cost

- For a local council entrusted to look after the community's assets and ensure they continue to provide services in alignment with its infrastructure and asset management plan, the use of depreciated replacement cost, and not market value based on highest and best use, provides the most meaningful information for users in making decisions.
- Compliance with the requirements of AASB 13 is likely to present the most challenges in attempting to determine appropriate treatment of land with or without buildings or structures attached. This is because:

  (a) the majority of assets entrusted to a local council do not have a market value; and

  (b) the highest and best use of an asset is interpreted widely and inconsistently by valuers.
- There is no market for assets such as roads, stormwater, bridges, footpaths, etc. and consequently fair value is calculated as depreciated replacement cost. This valuation methodology has a strong alignment to a council's infrastructure planning.

Community land assets

- SALGFMG considers that all local government owned sites that are designated as 'community land' under the provisions of the Local Government Act do not have a market value because they cannot be disposed of unless and until the 'community land' classification is revoked.
- Therefore, until the 'community land' classification is revoked, the asset's highest and best use is its current use. It therefore follows that any buildings and other structures on the land should not be valued based on a market value. Since these buildings are not held primarily to generate income, replacement cost is an appropriate basis of valuation.

Highest and best use is interpreted widely and inconsistently by valuers, often resulting in the fair value of buildings being measured at nil

- Some auditors and valuers interpret the requirements of AASB 13 para. 29 to mean that the current use can generally be taken to be the highest and best use, whilst others suggest that a local council could maximise an asset's sale price (exit price) by selling the asset for an alternative use.
- If a hypothetical buyer would need to demolish any existing structures on land to achieve a hypothetical highest and best use, then the price they are willing to pay for the structures (the fair value) is nil, or very little. This is taking the buyer's perspective, providing them with the highest and best use but minimising the current use from the perspective of local council (the seller).
- A nil or very low fair value does not seem appropriate for buildings that are in a perfectly good condition being utilised for a clearly local government specialised function, which reside on high-value land for which there may be perceived potential to develop a highly profitable commercial building.
- SALGFMG questions whether the fair value of such a building should be measured on the basis of its current use by the local council, or on the basis that the building is likely to be demolished by the hypothetical buyer to make way for an alternative building. SALGFMG supports the view that the fair value of the service potential of the existing asset is based on the current use of the asset by the Council.
- Councils have many assets such as depots, council civic buildings, libraries, etc. where, although the market might assess there exists a 'better' use of the property (by demolishing the existing building to make way for an alternative building), it is highly unlikely this alternative use will eventuate. Valuing the building, such as a civic building, based on its limited revenue-earning potential could be misleading to ratepayers and users of financial statements regarding the stewardship of assets, especially when this assessment often skews the fair value to nil.
- When the fair value of such assets is valued at nil, there is no depreciation recorded for those assets, resulting in a distortion of the council's financial position and operating surplus/deficit. It is more problematic when a new valuer values the asset based on its current use as the highest and best use.

S4–HoTARAC: **Supports fair value as currently applied under AASB 13**

- HoTARAC supports measuring the current value of all non-financial assets using fair value as currently applied under AASB 13. However, HoTARAC recommends the AASB considers developing further guidance and examples relevant to the public and NFP sectors. HoTARAC's view is that a single exit price for a specified asset is appropriate.
- It would be a departure from sector neutrality if COV was adopted in Australia. There may be assets held to generate income that are also used for service delivery. It is not sufficiently clear in the EDs which measurement basis to apply in this situation.

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AASB 13 provides a conceptually sound hierarchy for measuring fair value, with an easy-to-understand definition based on exit price. AASB 13 requires preparers to use a valuation technique that is appropriate and maximises observable (i.e. unbiased) inputs. HoTARAC is of the view that fair value derived from each of the three valuation approaches should be the same in most instances. Fair value provides a consistent measurement basis for all assets including restricted assets in the public sector. There is no evidence that using measures other than fair value would benefit users of financial statements.
The ‘highest and best use’ and ‘maximising the use of market participant data’ concepts should be retained for NFP entities.
The IPSASB proposals appear to be rules-based in mandating valuation methodologies in certain circumstances. A principles-based approach would define an overarching valuation objective.
The proposals would result in values of restricted assets that are not meaningful to users of financial statements. This is because many restricted assets would become ‘overvalued’ under the proposals and similar assets would have different values. There is a potential that inconsistencies would arise with how valuers would determine the value of restricted assets.
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<tr><td colspan="2">S5–ABS: Supports fair value as currently applied under AASB 13
Not supportive of any movement away from fair value, because fair value is the valuation basis most consistent with the GFS principle of market valuation. Obtaining the current market values of assets and liabilities can sometimes be challenging. The ABS accepts a market value equivalent, which to date has been fair value.
Any change from measuring assets at fair value would mean that the ABS would be receiving data that is not consistent with GFS principles, and data providers may need to keep separate records in order to provide the required GFS data.
</td></tr>
<tr><td>AASB SMC 2</td><td>In respect of <u>fair value</u>, do you agree with the AASB’s tentative view that hypothetical market participant buyers would include another NFP entity with similar service delivery objectives?</td></tr>
<tr><td colspan="2">S1–APV: Agrees – No other entity would be interested in acquiring such operational capacity assets.</td></tr>
<tr><td colspan="2">S2–API: Agrees – The NFP entity should be considered a potential market participant; otherwise there may be no market participants for that asset, which is impractical.</td></tr>
<tr><td colspan="2">S3–SALGFMG did not comment on AASB SMC 2.</td></tr>
<tr><td colspan="2">S4–HoTARAC: Qualified agreement
A hypothetical market participant could include another NFP entity because there could be other public sector entities or private NFP entities with similar service delivery objectives. For non-specialised assets, for-profit entities are also potential market participants.
However, there would be instances where another NFP entity with similar service objectives does not exist, in particular for highly specialised assets or where the service provided is unique to government. In this case, fair value should be based on a hypothetical market and considers the perspective of a market participant that holds the asset.
One HoTARAC member disagrees that a hypothetical market participant could include <u>another</u> NFP entity because most public sector assets are unique and there would be no other NFP buyers.
</td></tr>
<tr><td colspan="2">S5–ABS: Qualified agreement</td></tr>
</table>

• A hypothetical market participant could include another NFP entity with similar service delivery objectives, but there could also be circumstances where another NFP entity with similar objectives does not exist.

Topic B Definition of 'current operational value'

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 58–65]

AASB SMC 5	**Do you agree with the IPSASB's proposed definition of 'current operational value' or the alternative definition stated in paragraph AV3 of ED 76? If you disagree with both definitions, do you have suggestions for another definition of 'current operational value'? In answering this question, please indicate whether you consider that the definition of 'current operational value' should:** **(a) clearly reflect the service potential of operational capacity assets; and** **(b) focus on the cost of replacing the asset's service potential?** *The IPSASB's proposed definition of current operational value is "the value of an asset used to achieve the entity's service delivery objectives at the measurement date."* *The alternative definition of current operational value stated in paragraph AV3 of ED 76 is "the cost to replace the service potential embodied in an asset at the measurement date."*
S1–APV: Agrees with COV and prefers the alternative definition to focus on replacement cost • There is a fundamental error in the valuation approach decision tree for the current value model. If the assets are held to provide services to the community and measured at COV, then the only approach that could possibly be used to value the asset would be the cost approach. Neither the market nor the income approach would be appropriate. This is because, due to the nature of the assets, there would not be an open and active market nor would income generation be of importance. If the assets needed to be valued on these two approaches, then logically they should be valued at fair value irrespective of the reason why they are used by the entity. • Therefore, the definition of COV should represent the cost to replace the service potential currently embodied within the asset and be based on an 'entity specific entry price' under the cost approach.	
S2–API: Disagrees with COV and thus does not support either definition • The definition of a current value measurement basis should focus on the service potential of an operational capacity asset. This is essentially the 'value' the asset has to the reporting entity because the entity has a direct focus on the asset's current utility. • A focus on the cost to replace an asset may be appropriate for new assets. However, older assets are prone to obsolescence. • A definition of a current value measurement basis should support value-based judgements. • COV seems to require assets to be valued on a stand-alone basis and negates the 'in-combination' approach to highest and best use in AASB 13, which is a vital aspect of valuing government assets and assets subject to restrictive covenants – AASB 13 enables valuers to make the necessary value adjustments on an in-combination basis.	

• COV requires a set of hypothetical valuation parameters/assumptions on which to undertake valuations for financial reporting, which seems illogical in the market and requires greater subjectivity than fair value.
S3–SALGFMG: Supports a definition based on replacement cost and the current use of the asset.
S4–HoTARAC: Disagrees with COV and thus does not support either definition • The definition should be based on the principles of service potential of an asset and allow for appropriate valuation techniques to be applied while maximising observable inputs. The cost approach should not be the only approach used in valuing operational capacity assets. • Although HoTARAC prefers fair value to the value under either definition of COV, of those definitions it prefers the IPSASB's proposed definition to the alternative. • Nevertheless, the proposed definition should be clarified further because "the value of an asset" could be interpreted in different ways and could result in different valuation outcomes. For example, as commented in ED 76 para. AV4, "the value of an asset" could be the cost to replace the asset or its service potential, or the opportunity cost of using an asset to generate services, measured by reference to net cash inflows forgone.
S5–ABS: Disagrees with COV and thus does not support either definition • Not supportive of any movement away from fair value, as that is the valuation basis most consistent with the GFS principle of market valuation.

Topic C Measurement techniques for estimating the COV of an operational capacity asset: relevance of using the income approach

[Corresponds to ED 77 SMC 8, see Agenda Paper 13.3 paragraphs 154–164]

AASB SMC 6	**Do you agree with:** **(a) the IPSASB's proposal in ED 77 that the income approach can be an appropriate measurement technique in certain circumstances to estimate the COV of an operational capacity asset (paragraphs B24 and B38); or** **(b) the alternative view documented in ED 77 that the income approach would be inappropriate for estimating an operational capacity asset's COV because COV should focus on the cost to replace the service potential embodied in the asset (paragraphs AV5–AV12)?**
S1–APV: Disagrees – the income approach should not be permitted • APV strongly disagrees that the income approach should be used to measure the value of operational capacity assets. The example put forward by the IPSASB relates to heritage assets used to generate a cashflow. Under the IPSASB's framework, if an asset's value is reflected in its income-generating capability, it should be deemed as held to generate income and therefore be valued at fair value rather than COV. • The reality is that, for some assets, such as heritage assets or naturally occurring assets, it is impossible to assign a value that can be reliably determined. Allowing the use of the income approach would likely lead to some entities misusing the Standard to boost their own financial position. For example, entities may want to recognise the value of natural landscapes such as the Great Barrier Reef in their financial statements.	
S2–API: Agrees – the income approach should be permitted • The income approach based on a capitalisation of market rent would be appropriate when there is an established market.	

- However, API agrees that measurement using the income approach may not reflect the remaining service potential of an asset. For example, revenue collected from the gate to a national park is measurable, but it is uncertain which asset (or group of assets) have generated that revenue, and what expenses should be included to assess the net cash flows. In this example, the income approach does not appear to be appropriate for measuring the national park's fair value.

S3–SALGFMG did not comment on AASB SMC 6.

S4–HoTARAC: Agrees – the income approach should be permitted

- It is unlikely that the income approach would be appropriate for measuring operational capacity assets. However, HoTARAC is of the view that the general principles of valuation should apply when determining the most appropriate valuation technique.

S5–ABS: Agrees – the income approach should be permitted

- The ABS supports general principles of valuation, where a valuation technique is applied that is appropriate to individual circumstances and for which sufficient data are available to measure fair value.

Topic D Measuring the current value of an operational capacity asset based on its current use

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 66–71]

AASB SMC 7	**In respect of measuring the current value of an operational capacity asset, do you agree with:** **(a) the IPSASB's proposal that the asset's COV should be measured based on its current use, disregarding potential alternative uses and any other characteristics of the asset that could maximise its market value; or** **(b) extending application of the AASB's tentative view (that the fair value of an operational capacity asset should take into account its reinvestment potential), to apply to the measurement of either the asset's fair value or COV?**

S1–APV: Agrees with (b) – Fair value of an operational capacity asset should take into account its reinvestment potential

- All public sector entities need to be accountable and, if assets are being underutilised, the community has a right to be aware that more value could be achieved by rationalising these underutilised assets. As such, public sector entities should disclose the value of their assets at highest and best use.

S2–API: Disagrees with (a) and partially agrees with (b) – Current value measurement of operational capacity assets should be based on the asset's highest and best use. For a restricted asset, its current use may be its only use

- The valuer should undertake the valuation based on the asset's highest and best use. However, where an asset has a restricted use, its current use may be its only use, which is also its highest and best use.
- A restricted asset should be measured based on its existing use because it does not have an alternative use until the entity has declared the asset as surplus.
- An asset's reinvestment potential should be included in the asset's fair value only if the asset has been declared a surplus asset and is no longer being held for its operational capacity.

- Not all specialised improvements are on restricted use land. For example, a school building might be on land zoned for a higher use. A valuer would need to consider the highest and best use of the land and improvements on that land as a single property when estimating fair value.
- API also provided an example of a public school situated on residential zoned land. Due to a demographic change, demand for the public school has declined. Because there is no market demand for public schooling, the market would attribute a nil or negative value to the school building. Therefore, the market value for the site would be the value of a residential development site.

S3–SALGFMG: Agrees – Current value measurement of operational capacity assets should be based on the asset's current use

- SALGFMG considers that all local government-owned sites that are designated as 'community land' under the provisions of the *Local Government Act 1999* do not have a market value. 'Community land' cannot be disposed of unless and until the 'community land' classification is revoked. Therefore, the highest and best use of these assets is their current use.
- SALGFMG supports deriving the fair value of the service potential of the existing asset based on the current use of the asset by the Council.

S4–HoTARAC: Disagrees with (a) and partially agrees with (b) – Current value measurement of operational capacity assets should be based on the asset's highest and best use. Many public sector assets have no alternative uses

- There might be instances in which an operational capacity asset has alternative uses that are legally, economically and physically feasible, and these limited alternative uses should be considered.
- Restrictions on the sale or usage of an asset imposed by a government are considered characteristics of the asset that a market participant would take into account when pricing the asset. This is because any entity holding the asset would not be able to change those restrictions without government's approval.
- Therefore, in accordance with AASB 13 para. 11, consideration of alternative uses of an asset should not include alternative uses that are not feasible under the current restrictions imposed on the asset.
- If an asset's reinvestment potential is considered in measuring its current value, that reinvestment potential should be based on any legal, financial, physical and other restrictions imposed on that asset.
- For example, the current value of a parcel of land that has a restricted use as a national park should not be based on an alternative use as a residential housing site that is not feasible under the current zoning restriction. If the current value of that restricted land includes the reinvestment potential based on a residential housing site, the resulting valuation would not provide meaningful information to users of financial statements.
- While reinvestment potential is relevant for surplus assets, it is not relevant for operational capacity assets, which are not intended to be sold.

S5–ABS Disagrees with (a) and (b)

- ABS supports fair value measurement and expressed a view that all characteristics of the asset should be take into account if market participants would take those same characteristics into account when pricing the asset.

Topic E Measuring the current value of restricted operational capacity assets

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 72–93]

AASB SMC 8	**In respect of restricted operational capacity assets, if an equivalent restricted asset is obtainable in the marketplace, do you agree with the IPSASB's proposal in ED 77 (and the AASB's tentative view) that the current value of such restricted operational capacity assets should be measured based on the available market evidence for the equivalent restricted asset?**
AASB SMC 9	**In respect of restricted operational capacity assets, if an equivalent restricted asset is not obtainable in the marketplace, do you agree with the IPSASB's proposal in ED 77 (and the AASB's tentative view) that the current value of such restricted operational capacity assets should not be lower than the current value of an equivalent unrestricted asset?**
AASB SMC 10	**Would your answer to AASB SMC 9 (for restricted operational capacity assets generally) be different in respect of measuring the current value of restricted land for which equivalent restricted land is not obtainable in the marketplace?**

S1–APV: Agrees with SMC 8–10 – Fair value of restricted assets should be measured using the cost approach without a reduction for the restrictions, under certain circumstances

- Agrees with the IPSASB proposals and the AASB's tentative decision that the fair value of restricted assets (including restricted land), if there is no market evidence of a sale of asset with the same restrictions, should be valued using the cost approach with no reduction for the restriction.
- In respect of restricted land, while there may not be an easily identified reference site for valuation purposes, valuers are trained to analyse the market and can determine a valuation estimate based on the market evidence of dissimilar land sales using high-level trend analysis. This would involve a range of assumptions and should be differentiated in the financial statements as land valued using level 3 inputs rather than level 2 inputs. The disclosures should provide information about those assumptions and how they were evaluated for reasonableness. Once disclosed, this information provides users of the financial statements with sufficient information to make an informed decision.

S2–API: Agrees with SMC 8 and disagrees with SMC 9 and 10 – The fair value of restricted assets should not be measured without a reduction for the restrictions

- Disagrees with measuring restricted land, without adjustments, at a value of commonly traded nearby land that does not have the same level of restricted land use.
- Agrees that the fair value of a restricted asset should be measured at the cost to replace the asset, including consideration of what is financially feasible, physically possible and legally permissible. However, the 'cost to replace the asset' should not be the cost to replace a similar but unrestricted asset. An adjustment is applied to reflect the restrictions on the land's use, which negates the inclusion of any value reflecting opportunity costs.
- The value of land is not limited to the site and the location. The bundle of legal rights attached to the land and title are a significant part of valuation considerations. Land use instruments (e.g. zoning, development controls, state planning law and purpose clauses for leasehold land) will have a significant impact on the value.
- Restrictions need to be appropriately quantified and applied when undertaking a valuation of an encumbered restricted asset. Restrictions should be considered regarding the total asset value, and not only regarding the value of the restricted land.

- The IPSASB's proposals are not consistent with valuation approaches to assessing value in practice and would lead to similar assets being measured at significantly different values.
- If the IPSASB's proposals are adopted, it would lead to enormous uplifts in value for many restricted assets, where the reported values would not reflect the use of those assets in the foreseeable future or possibly ever. The resulting values would therefore not reflect how governments have decided to use those assets.
- The proposals would be difficult to apply in practice because it might be impossible to identify an equivalent unrestricted asset in the market.

S3–SALGFMG did not comment on AASB SMC 8–10 directly. However, it expressed the view that buildings in good condition on community land and utilised for a local government specialised function should not be valued at nil or a very low amount.

SALGFMG also commented that the fair value of such a building should be measured on the basis of its current use by the local government, and not on the basis that it is likely the building will be demolished by the hypothetical buyer to make way for an alternative building to achieve a higher or better use.

S4–HoTARAC: Agrees with SMC 8 and disagrees with SMC 9 and 10 – The fair value of restricted assets should not be measured without a reduction for the restrictions

- The service potential of a restricted asset is lower than the service potential of an equivalent unrestricted asset. For example, if a school zoning restriction is imposed on a parcel of land, the entity holding this parcel of land would not be able to use it for any other purpose, such as residential development, unless the land is rezoned accordingly.
- The IPSASB EDs do not distinguish between restrictions the entity can unilaterally remove and those that require approval or agreement from other parties. Restrictions imposed by community views should also be considered in an asset's current value. Rezoning land in Australia requires support of local councils, consultation with the community and approval of the State or Territory Governments. Rezoning is sometimes imposed by law (e.g. rezoning land under cemeteries). Therefore, governments do not always have full discretion over rezoning of land. This supports HoTARAC's view that zoning restriction is an intrinsic characteristic of land and a market participant would value the land based on its current restricted use.
- Agrees that replacement cost can be applied to estimate fair value where appropriate, but it should be based on the cost to replace the specific asset, including all relevant restrictions, and not on the cost of replacing a similar but unrestricted asset.
- The proposal to measure the current value of a restricted asset at the value of an equivalent unrestricted asset would effectively reflect an economic opportunity cost approach, but not necessarily reflect the existing characteristics of the asset. This concept does not align with the measurement bases in the Conceptual Framework.
- For measuring restricted assets, the proposals suggest a rules-based approach rather than principles-based valuation concept. HoTARAC is of the view that any measurement basis should be principles-based and be applicable in all circumstances.
- In practice, the proposals could lead to similar (or identical) assets being measured at significantly different values. For example, if land under two identical schools in identical regional towns is subject to valuation, a valuer in one town might determine that there is equivalent restricted land obtainable in valuing the fair value of the school land. However, in the other town another valuer might determine that equivalent restricted land is not obtainable in the marketplace and, under the proposal in ED 77 para. B14, value the school land at something in the order of 10 times the value of the other school's land. Even then, the second valuer might use either of two widely differing values depending on their assessment

of whether the ‘equivalent’ unrestricted land is nearby residential land or nearby commercial land.

- The proposals would be difficult to apply in practice, because valuers may have different interpretations of an ‘equivalent asset’. It would be costly to apply the proposals because the impact would be material and many valuations will need to be fundamentally rescoped.
- Most Australian public sector entities reflect restrictions in the fair value of their restricted assets. This approach is well understood by valuers and there is sufficient audit evidence to support the discounts being applied to these valuations.
- It should not be necessary to value restricted land and the buildings on that land using the same valuation techniques. HoTARAC considers that specialised assets on land might require another technique than the market approach because it is highly unlikely that there would be equivalent comparable specialised buildings for sale in the market.
- If the valuation objective is an exit price based on fair value, the market value of land should be the same as its replacement cost. However, it could be possible to value a specialised building using different valuation techniques. This is because the building was constructed specifically to provide a particular service, such as a school building built specifically to provide schooling; whereas land does not have any inherent service potential limited to that specific purpose.
- ED 77 isn’t clear what would be an acceptable ‘equivalent unrestricted asset’ because the asset that provides services of the same nature would be another restricted asset. That is, the notion of an ‘equivalent restricted asset’ will often in practice be self-contradictory. For example, for a cemetery, an equivalent asset must provide services of the same nature (i.e. another cemetery); it is unclear how to value restricted assets if there are no equivalent restricted or unrestricted assets obtainable in the marketplace. In addition, land assets have legal restrictions attached through zoning. HoTARAC considers that ED 77 isn’t clear what type of land could be considered ‘unrestricted’ for the purpose of ED 77 para. B14.
- The proposals would lead to significant uplifts in value for many types of public sector assets where those reported values will not reflect the use of those assets in the foreseeable future. Inflating the value of these assets would not provide better information to users about a government’s accountability or management of assets such as schools, Crown land, national parks, hospital land, cemeteries, etc. because:

  (a) if an asset is valued at its theoretical unrestricted value, any government decision to remove the restriction would not result a corresponding change in value of the asset. For example, if a government changes the use of land zoned for a national park in an urban area, to residential zoning, the effect of the decision should be reflected in changes in the asset’s fair value;

  (b) the restricted value provides information about the characteristics of that specific asset. The proposals would provide information about another asset or the existing asset with different characteristics;

  (c) users would assume assets are measured based on their existing characteristics. The uplift in values would reflect potential future uses of those assets but, in most cases, those alternative uses are unlikely to happen. The proposals would necessitate significant disclosures, so users can understand assets are, in fact, valued based on an alternative premise; and

  (d) it will result in public sector assets being valued under two different principles: exit price and entry price. Using a single principle still allows for different valuation techniques, subject to the overriding principle.

• HoTARAC also understands there may be land assets that are currently not recognised because their restricted values are immaterial. These may need to be recognised if the unrestricted replacement cost is material. Examples include some national parks, marine parks, the exclusive economic zone and land under water. The potential impact could be many billions of dollars. In HoTARAC's view, these unrestricted values would not necessarily provide useful information about the underlying assets.
S5–ABS: Agrees with SMC 8 and disagrees with SMC 9 and 10 – The fair value of restricted assets should not be measured without a reduction for the restrictions • Conceptually, an asset with restricted use is not equivalent to a similar asset without restrictions and therefore should not have a comparable valuation. The IPSASB proposal and the AASB's tentative view do not fit with the principles of either market valuation or fair valuation. • When measuring the value of an asset, all characteristics of the asset should be taken into account if market participants would take those same characteristics into account when pricing the asset. • Governments are required to provide specific services to the public, primarily on a non-market basis. This imposes restrictions on the use and disposal of assets in the public sector. Restrictions are therefore relevant characteristics to consider when valuing an asset at a given point in time, until such restrictions are lifted.

Topic F Assumed location of an operational capacity asset used to measure its current value

[Corresponds to ED 77 SMC 7, see Agenda Paper 13.3 paragraphs 146–153]

AASB SMC 11	**Do you agree with the IPSASB's proposal in ED 77 (and the AASB's tentative view in the context of fair value) that an asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location in which the existing asset is situated or used?**
S1–APV: Agrees – An asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location • To assume another location creates an extremely hypothetical scenario which significantly increases the level of uncertainty. Furthermore, given the asset is already providing its service in its present location, for most assets it would be unlikely that such an asset could easily be transferred to a different location. That is, it is most likely that the asset will continue to operate from the same location and undergo regular enhancement over time.	
S2–API: Agrees – An asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location • Current value measurement is an assessment of value at a point in time. The fundamental assumption of such a valuation is of a going concern asset in situ, hence it seems illogical not to assume that the asset will continue to be used for service delivery, unless advised otherwise (which is usually in accordance with AASB 5 *Non-Current Assets Held for Sale and Discontinued Operations*).	
S3–SALGFMG did not comment on AASB SMC 11.	
S4–HoTARAC: Agrees – An asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location • HoTARAC supports measuring operational capacity assets at fair value. Under AASB 13 para. 11, the location of an asset needs to be taken into account when measuring the asset's fair	

value, if the location impacts pricing of the asset by market participants. • Valuation of assets should be based on the existing asset and not on a hypothetical asset. Valuations reflecting the asset's location would help inform government decisions and users of financial statements about possible future relocations.
S5–ABS: Agrees – An asset's current value assumes that the entity will continue to meet its service delivery objectives from the same location • Consistent with AASB 13, when measuring fair value, an entity should take into account particular characteristics of the asset if market participants would take those same characteristics into account when pricing the asset, including the location of the asset.

Topic G Nature of the component costs to include when considering the cost of a modern equivalent asset

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 97–115]

AASB SMC 12	**When estimating the cost of a modern equivalent asset to measure the current value of an operational capacity asset, do you agree with:** **(a) the IPSASB's proposals in ED 77 that the cost of a modern equivalent asset may in some circumstances exclude certain costs (paragraph B35); or** **(b) the AASB's tentative view that all necessary costs intrinsically linked to acquiring or replacing an asset at the measurement date should be included?**
S1–APV: Agrees with (b) – Valuation should be based on the assumption that the asset does not presently exist and take into account all costs that would be necessarily incurred • The IPSASB's proposals in (a) and the AASB's tentative view in (b) are not mutually exclusive. • Under the AASB's tentative view, the cost would include all necessary costs assuming the asset does not presently exist but would need to take into account any costs that would be necessarily incurred. Under the IPSASB's proposals the costs that are excluded relate to costs associated with enhancing the asset from its current size and specification. • Under both approaches, APV would be valuing the equivalent service potential delivered by the existing asset but based on the modern equivalent. As such, both should be based on the assumption that the asset does not presently exist but would need to take into account all costs that would be necessarily incurred. • Both approaches provide useful clarification that the replacement cost of the modern equivalent needs to be adjusted to reflect the service potential delivered by the existing asset (i.e. similar size and specification).	
S2–API: Agrees with (b) – All necessary costs intrinsically linked to acquiring or replacing an asset should be included • Replacement costs provided by Quantity Surveyor or similar resource are inclusive of all relevant construction costs and should be relied upon as experts.	
S3–SALGFMG did not comment on AASB SMC 12.	
S4–HoTARAC: Disagrees with (a) but did not specifically support (b) • The principles of including 'all necessary costs' and 'in some circumstances excluding certain costs' are not necessarily mutually exclusive. Additional guidance on the concept of the cost of a 'modern equivalent asset' would be beneficial.	

• Disagrees with the IPSASB's proposals in ED 77, which are rules-based to exclude certain costs based purely on their nature or function. It is unclear why ED 77 excludes in all cases the costs of extending an asset and of contract variations. HoTARAC considers that costs should be included where they relate to the fair value of a modern equivalent asset. Guidance should focus on whether there is a nexus between the cost and that fair value.
S5–ABS did not comment on AASB SMC 12.

Topic H Whether borrowing costs should be included when considering the cost of a modern equivalent asset

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 116–124]

AASB SMC 13	**In respect of measuring the modern equivalent asset as part of the estimation of an operational capacity asset's current value, do you agree with:** **(a) the IPSASB's proposal in ED 77 that if an entity does not capitalise borrowing costs in accordance with its accounting policy, the entity should disregard any financing costs (paragraph B35(a)); or** **(b) the AASB's tentative view that the accounting policy choice regarding whether to capitalise borrowing costs into an asset's cost on initial recognition is irrelevant to how those costs should be treated when measuring the current value of the asset?**
S1–APV: Agrees with (a) – Only include borrowing costs if the entity would also capitalise borrowing costs if it were to replace the asset • It is uncommon in Australia to find NFP public sector entities that capitalise borrowing costs. Typically, this is because the over-riding jurisdictional requirements mandate that borrowing costs be expensed. • The AASB tentatively decided that consideration should be given to whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset. In determining the nature of another market participant, it would be appropriate to assume that the other market participant would be similar in nature; and therefore, have a similar accounting policy regarding capitalisation of borrowing costs. That is, if the entity that holds the asset would normally have capitalised the borrowing costs, then it would also be appropriate for the valuation to build in an allowance for capitalised interest.	
S2–API: Agrees with (b) – The accounting policy choice regarding whether to capitalise borrowing costs into an asset's cost on initial recognition is irrelevant to how those costs should be treated when measuring the current value of the asset.	
S3–SALGFMG did not comment on AASB SMC 13.	
S4–HoTARAC: Majority of HoTARAC members agree with (b) and two members agree with (a) • The IPSASB's proposals would mean that for-profit entities and NFP entities assets would have different fair values. This would not align with the sector neutrality principle. • Measuring fair value is different to measuring the historical cost of assets at initial recognition. An entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions.	
S5–ABS did not comment on AASB SMC 13.	

Topic I Consideration of surplus capacity and economic obsolescence

[Corresponds to ED 77 SMC 5–6, see Agenda Paper 13.3 paragraphs 125–145]

AASB SMC 14	**Do you agree with the IPSASB's proposal in ED 77 that the COV of an operational capacity asset should assume the asset is used to its full capacity, subject to any tests for impairment (paragraph B11)?**
AASB SMC 15	**Do you consider the guidance in ED 77 to be sufficiently clear in distinguishing whether a loss of utility of an asset should be treated as:** **(a) surplus capacity, as described in paragraphs B10 and B11 (which is not adjusted for when measuring the asset's COV); or** **(b) an indication of economic obsolescence, as described in paragraph B36(c) (which is deducted when measuring the asset's COV); or** **(c) an indication of impairment?**

Respondents did not comment directly on SMC 15 about whether ED 77 has sufficient guidance on this topic.

S1–APV: Did not comment on SMC 14 about whether COV measurement should assume that the asset is being used to its full capacity. However, staff interpreted from other comments made by this respondent in the covering letter of its submission that it would disagree with the IPSASB's proposals that COV measurement should assume that the asset is being used to its full capacity, because obsolescence should be considered.

This is because APV agrees with the AASB's tentative view that:

(a) the fair value of the asset should be adjusted downwards to reflect obsolescence, including economic obsolescence in respect of any decrease in service potential required; but
(b) no adjustment should be made in the determination of the asset's current replacement cost if an asset's excess capacity is considered to be of a temporary or cyclical nature.

S2–API: Disagree with SMC 14 – Current value measurement should not always assume that the asset is being used to its full capacity

- An adjustment shall be deducted from the service capacity of the asset or from the useful life of the asset, if an asset is not being used at its full capacity.
- The loss of utility of an asset should be treated as an indication of economic obsolescence. The valuer would consider at what capacity the asset is operating and what is contributing to the reduction in operating capacity.

S3–SALGFMG did not comment on AASB SMC 14–15.

S4–HoTARAC: Disagree with SMC 14 – Current value measurement should not always assume that the asset is being used to its full capacity

- Agrees with the AASB's tentative views expressed in the working draft ED presented to the Board at its March 2020 meeting. Appendix F, para. F25 states that if an asset has apparent overcapacity in view of current demand for its services, economic obsolescence shall not be identified for that asset if there is more than an insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future.
- The guidance on how surplus capacity is distinguished from economic obsolescence is not sufficient. Guidance and illustrative examples should be provided to explain differences between surplus capacity, economic obsolescence and impairment. Specifically, ED 77 para. 10 states that "surplus capacity exists when an asset is not used to its maximum capacity. For

example, an entity owns a building, but only utilises 80% of the space available and the remaining 20% is left vacant". It is not sufficiently clear why this would not constitute economic obsolescence, in accordance with para. 36(c). • Public sector assets are often constructed in anticipation that future demand for services might be considerably higher than the current demand. In these circumstances, revaluation decrements resulting from under-capacity would not provide useful information to users. It would result in fluctuations due to subsequent revaluation increments, as the assets' planned capacity is taken up. • In the for-profit sector, anticipated future cash flows resulting from the uptake of current under-capacity will be included in the fair value estimate if the income approach is applied. Therefore, similarly in the public sector, a temporary and planned surplus capacity should not reduce the fair value of the asset. Where the entity plans to utilise the surplus capacity in the future, the temporary over-capacity should be ignored in estimating fair value. However, unplanned or long-term over-capacity should be considered.	
S5–ABS did not comment on AASB SMC 14–15.	
AASB SMC 16	**Do you agree with the Alternative View in paragraph AV17 of ED 77 that, when an asset includes surplus capacity that is severable from the asset and surplus to operating requirements:** **(a) the unit of account for the asset's measurement should be bifurcated; and** **(b) the severable part of the asset should be classified and measured as an asset held for its financial capacity (i.e. with its current value consequently measured at fair value instead of COV under the proposals in ED 76 and ED 77)?**
S1–APV: Disagrees with para. AV17 • Disagrees that the severable part of the asset is 'held for its financial capacity'. It is more likely simply held as excess capacity due to changes over time in demand and technology. In some cases, the excess capacity may be severable but, in most cases, would not be severable. • There is no benefit in bifurcating the asset, it will only add complexity and unreliability. • It appears that the AASB SMC has confused the adjustment for a difference in utility between the existing and modern equivalent asset with the subsequential adjustment for obsolescence to determine the asset's COV. • There remains a level of ambiguity within the IPSASB EDs and AASB 13, as many practitioners still try to use depreciation expense concepts to determine the current value rather than general obsolescence and condition, etc. This is despite both IFRS 13/AASB 13 and ED 77 highlighting that the adjustment for obsolescence is conceptually different and much broader than depreciation for financial reporting purposes.	
S2–API: Conditionally agrees with (b) – Surplus capacity should only be bifurcated if it has been declared by the entity as surplus. Surplus capacity should be measured at its current replacement cost (fair value).	
S3–SALGFMG did not comment on AASB SMC 16.	
S4–HoTARAC: **Conditionally agrees with (b)** – Surplus capacity should be bifurcated if the entity plans to dispose of that capacity, and measured under the rules applicable to assets held for their financial capacity.	
S5–ABS did not comment on AASB SMC 16.	

Topic J Value in use as a measurement basis identified in the IPSASB's Conceptual Framework

[Corresponds to ED 76 SMC 4, see Agenda Paper 13.3 paragraphs 38–44]

AASB SMC 17	**Do you agree with the IPSASB's proposal to remove 'value in use' from the list of measurement bases in the IPSASB Conceptual Framework?**
S1–APV: Agrees • IPSAS should be adjusted to reflect the position of AASB 136 where specialised assets that are not held for generation of cash (and therefore valued at COV) should be exempted from applying the impairment Standard.	
S2–API: Disagrees – VIU is currently being utilised and well understood by users of financial reports.	
S3–SALGFMG did not comment on AASB SMC 17.	
S4–HoTARAC: Agrees – but value in use should be retained in the IPSASB Standards relating to impairment of assets.	
S5–ABS did not comment on AASB SMC 17.	

Appendix C: High-level summary of the comments received on ITC 45 from Panel meeting and virtual outreach event

For the Specific Matters for Comment (SMCs) in ITC 45 to be deliberated by the Board at this meeting, a high-level summary of the comments received from the meeting with the Fair Value Measurement Panel held on 29 June 2021 and the virtual outreach event held on 6 July 2021 is set out below for Board members' reference.

The Board considered a high-level summary of comments from that meeting and event on other SMCs at its August 2021 meeting (Agenda Paper 5.1, Appendix B).

ED 77 SMC 6: Do you agree that the guidance accompanying the proposed definition of COV is appropriate for public sector entities? (*This question is separated in two parts below*)
A: When measuring the current cost of a modern equivalent asset to measure the current value of an operational **capacity** asset, do you agree with: (a) the IPSASB's proposals in ED 77 (para. B35) that the cost of a modern equivalent asset may in some circumstances exclude certain costs; or (b) the AASB's tentative view (in the context of fair value) that all necessary costs intrinsically linked to acquiring or replacing an asset at the measurement date should be included?
Feedback received from the Panel meeting A majority of those who commented did not express an overall preference for either of the options in (a) or (b) above. They agreed with the need for an overarching principle for which costs to include (which is similar to option (b)) but also agreed with some of the proposals in IPSASB ED 77 para. B35 (which are referred to in (a)). Their main concern was the lack of a conceptual approach to the identification of relevant costs in IPSASB ED 77. ***Specific comments by Panel Members*** • One Panel member expressed concern that the IPSASB's proposals were based on the nature of costs, which is not principle-based; and • Mixed views were expressed by some Panel members about the need for guidance on how to treat 'greenfields' and 'brownfields' costs: one commented that AASB 116 *Property, Plant and Equipment* and AASB 13 provide the answers, while another commented that those terms are still used in practice.
This issue was not discussed at the virtual outreach event.
B: In respect of measuring a modern equivalent asset as part of estimating the current value of an operational capacity asset, do you agree with: (a) the IPSASB's proposal in ED 77 (para. B35(a)) that, if an entity elected not to capitalise borrowing costs, it should disregard any financing costs; or (b) the AASB's tentative view that the accounting policy choice regarding whether to capitalise borrowing costs into an operational capacity asset's cost on initial recognition is irrelevant to how those costs should be treated when measuring the asset's current value?
Feedback received from the Panel meeting A majority view was not discerned in relation to this issue. ***Specific comments by Panel Members*** • One Panel member personally disagreed with the IPSASB proposal in (a) but noted their view might not necessarily accord with the view of HoTARAC, since HoTARAC was still determining its view in relation to this issue;

• One Panel member commented that if borrowing costs were included in the measurement of an operational capacity asset's current value, equity costs should in principle also be included; • Some Panel members commented that, in principle, borrowing costs should be included in the measurement of an operational capacity asset's current value, but also that borrowing costs typically would be immaterial, except in relation to some infrastructure assets (e.g. service concession infrastructure, hospitals and tunnels); • One Panel member commented that borrowing costs should be excluded from the measurement of an operational capacity asset's current value, and noted that the 'instant build' assumption is often used to exclude consideration of borrowing costs in the measurement of the current value of operational capacity assets; and • One Panel member commented that the answer should depend on the circumstances (e.g. private sector constructors of infrastructure incur borrowing costs at a higher interest rate than the government's borrowing rate and include those borrowing costs in the contractual consideration for the infrastructure assets).
This issue was not discussed at the virtual outreach event.
ED 77 SMC 7: Do you agree the asset's COV should assume that the notional replacement will be situated in the same location as the existing asset is situated or used?
Feedback received from the Panel meeting A majority of those who commented agreed with the IPSASB's proposed 'existing location' assumption. Reasons given for this view included: • it is unnecessary to look to other locations because the asset is already held in its existing location, and has an objective value in that location. Some others argued, similarly, that valuing an asset in its existing location is consistent with the principle of measuring the asset you have, rather than a substitute asset; and • valuations of real property should reflect its existing location because location is an intrinsic aspect of the value of real property. A minority of those who commented disagreed with the IPSASB's proposed 'existing location' assumption. The reason given by one Panel member was that there are numerous examples of governments relocating facilities, and therefore it should not necessarily be assumed that a service will continue to be provided in its current location.
Feedback received from the virtual outreach event A majority of those who commented agreed with the IPSASB's proposed 'existing location' assumption. Reasons given for this view included: • selecting an appropriate alternative site would often involve subjective assessments among a range of alternatives, potentially with different values; and • valuations of real property should reflect its existing location because location is an intrinsic aspect of the value of real property, and reflects the key objectives for holding that property (i.e. to deliver services in a particular location). A minority of those who commented disagreed with the IPSASB's proposed 'existing location' assumption. However, reasons were not provided for their view.