AASB Exposure Draft

ED 31X
[Month] 2022

Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows

Comments to the AASB by [date]

Note 1 to Board members – Introduction

1. This paper is a working draft Exposure Draft (ED) annotated with notes and questions for Board members.
2. At its November 2021 meeting, the Board considered a staff paper (but not in an ED format) that included draft modifications to AASB 13 *Fair Value Measurement*, and draft Basis for Conclusions (BC) paragraphs regarding:
   (a) identifying the market participant assumptions for, and highest and best use of, specialised assets; and
   (b) the application of the cost approach.
3. Since November 2021, staff have:
   (a) prepared draft text to all sections of the ED; and
   (b) updated the draft authoritative implementation guidance (IG) and BC based on Board members' discussion at the November 2021 meeting and stakeholder feedback received from targeted outreach in December 2021–January 2022.
4. At the February 2022 meeting, staff ask the Board to decide the content of the ED. For Board members' ease of reference, key changes made to those BC paragraphs since the November version reviewed by the Board are marked up in this paper.
5. The draft paragraphs F3–F7 in this paper, which are draft IG regarding market participant assumptions, are identical to those included in Agenda Paper 9.2. After the February 2022 meeting, staff will update the ED based on the Board's feedback on Agenda Paper 9.2.
6. Therefore, the questions to Board members in this paper focus on:
   (a) the draft BC relating to the draft IG on market participant assumptions;
   (b) the updated draft IG on the highest and best use of an asset and related BC;
   (c) the updated draft IG on the application of the cost approach and related BC; and
   (d) other sections of the ED not yet considered by the Board.

Australian Government
Australian Accounting Standards Board

<u>Note 2 to Board members – Terminology used in describing the scope of the ED</u>

7. Staff propose using the phrase in AASB 136 *Impairment of Assets* para. Aus5.1: "non-financial assets not held primarily for their ability to generate net cash inflows" to describe the scope of the ED, instead of the phrase "non-financial assets held primarily for their service capacity" used in previous agenda papers.
8. At the meeting of the Fair Value Project Advisory Panel (the Panel) held on 1 December 2021, the majority of Panel members who commented on the terminology used expressed the view that the phrase in AASB 136 para. Aus5.1, which is used as the scope delimiter in AASB 136, is generally working well.
9. In addition, some Panel members expressed concern that "non-financial assets held primarily for their service capacity" may be ambiguous because all non-financial assets, whether held for commercial or not-for-profit-specific purposes, are held to provide services. Therefore, the majority of Panel members who commented said a case has not been made to change the phrasing of that scope delimiter and it would make sense to use consistent terminology in AASB 13.
10. Staff note that using "non-financial assets held primarily for their service capacity" would reduce the number of negatives in the ED's title, but, on balance, consider that the arguments provided for using the phrase in AASB 136 are more persuasive.

Questions for Board members

Q1: Do Board members agree with using the phrase "non-financial assets not held primarily for their ability to generate net cash inflows" to describe the scope of the ED?

Q2: Do Board members agree with the proposed title of the ED?

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by [date].

Formal Submissions

Submissions should be lodged online via the "Current Projects – Open for Comment" page of the AASB website (www.aasb.gov.au/current-projects/open-for-comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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Introduction

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Why we are making these proposals

Some stakeholders have provided feedback to the AASB that there is divergent practice by not-for-profit public sector entities in applying the principles in AASB 13 *Fair Value Measurement* in measuring the fair value of non-financial assets. In particular, these stakeholders asked the AASB to provide guidance on how to measure the fair value of non-financial assets that are not held primarily for their ability to generate net cash inflows. The AASB considered the feedback received and decided to address the implementation issues.

What we are proposing

This Exposure Draft proposes authoritative implementation guidance to AASB 13, and includes illustrative examples, for application by not-for-profit public sector entities.

Specifically, this Exposure Draft proposes implementation guidance in respect of non-financial assets not held primarily for their ability to generate net cash inflows, regarding:

(a) the market participant assumptions to use in measuring the asset's fair value;

(b) the asset's highest and best use; and

(c) the application of the cost approach if used to measure the asset's fair value.

Who will be affected

The proposals in this Exposure Draft would be applicable to not-for-profit entities in the public sector that are required to prepare general purpose financial statements.

Transition requirements

It is proposed that this amending Standard would be applied prospectively.

Application date

It is proposed that this amending Standard would be applicable to annual periods beginning on or after 1 January 2024, with early application permitted.

Note 3 to Board members – Prospective application and effective date

11. Staff's reasons for recommending prospective application of the proposed IG are set out in draft paragraphs BC178–BC181.
12. Questions for Board members on prospective application and the effective date are included in the BC section.

What happens next

The AASB will consider feedback on this ED at future meetings and, based on the information received, will determine whether the proposals should form the basis of an amending Standard, with or without further amendment. Depending on the nature and extent of the feedback, the AASB may publish a Fatal-Flaw Review Draft to enable further consultation with stakeholders.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by [date]. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Specific matters for comment

The AASB would particularly value comments on the following proposals made specifically in respect of non-for-profit (NFP) public sector entities regarding fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows:

Market participant assumptions

1 In respect of the assumptions used in measuring the fair value of a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, do you agree with paragraphs F4–F5 that:

(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, obviating the need to identify those assumptions) should be used to estimate the fair value of the asset; and

(b) if the market selling price of an identical asset is not directly observable, the entity would need to explicitly estimate the pricing assumptions that market participants would use. In this case, to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:

(i) if all relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity should use those assumptions in measuring the fair value of the asset;

(ii) 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) should 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

(iii) if no relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity should use its own assumptions in measuring the fair value of the asset?

Please provide reasons to support your view.

2 Do you agree with the examples of assets included in paragraph F7 for which neither:

(a) the market selling prices for an identical asset are likely to be directly observable; nor

(b) relevant information about different assumptions of other market participants is likely to be reasonably available?

Please provide reasons to support your view.

Highest and best use

3 Do you agree with the draft implementation guidance in paragraph F8 for NFP public sector entities applying the 'financially feasible use' concept described in AASB 13 paragraph 28(c) to identify the highest and best use of an asset not held primarily for its ability to generate net cash inflows? Please provide reasons to support your view.

4 Do you agree with paragraphs F9–F10 that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, the presumption that the asset's current use is its highest and best use should be rebutted when, and only when, at the measurement date, the appropriate level of the entity's management has committed to a plan to locate a buyer of the asset (or transfer the asset to another entity) or to use the asset for an alternative purpose? Please provide reasons to support your view.

Application of the cost approach

Questions 5–12 relate to 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 when applying the cost approach under paragraphs B8–B9.

5 Do you agree with paragraph F11(a) that the entity should assume the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location? Please provide reasons to support your view.

6 Do you agree with paragraph F11(b) that the entity should assume that the asset subject to measurement (the subject asset) presently does not exist; and therefore, all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date should be included in the asset's current replacement cost? Please provide reasons to support your view.

7 Do you agree with paragraphs F11(b) and F11(c) that, when estimating the current replacement cost of the subject asset, the entity should estimate the replacement cost of a reference asset (i.e. a modern equivalent asset or a replica asset) as input and adjust the estimated replacement cost of a reference asset for any differences between the reference asset's current service capacity and standard of finish, and those of the subject asset? Please provide reasons to support your view.

8 Do you agree with paragraph F12(a) that once-only costs that would be expected to be incurred in a hypothetical acquisition or construction of the subject asset should be included in the subject asset's current replacement cost? Please provide reasons to support your view.

9 Do you agree with paragraph F12(b) that an entity should apply judgement in the circumstances of the subject asset to determine whether the following costs would (among other costs) need to be incurred upon the hypothetical acquisition or construction of that asset at the measurement date:

(a) unavoidable costs of removal and disposal of unwanted existing structures on land; and

(b) any disruption costs that would hypothetically be incurred, when acquiring or constructing the subject asset at the measurement date, including costs of restoring the assets of another entity outside the consolidated group (if any) to which the holder of the subject asset belongs?

Please provide reasons to support your view.

10 Do you agree with paragraph F12(c) that an NFP public sector entity includes in the subject asset's current replacement cost all necessary costs required to be incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity? Please provide reasons to support your view.

Please note that Illustrative Example 1 and 2 illustrate the application of paragraphs F11–F12.

Economic obsolescence

11 Do you agree with paragraph F13 that identifying economic obsolescence should not be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity? Please provide reasons to support your view.

12 Do you agree with paragraph F14 and the example in paragraph F15 that economic obsolescence should not be identified for an asset for any 'surplus capacity' that is necessary for stand-by or safety purposes (e.g. to deal with contingencies), even if it seldom or never is actively utilised? Please provide reasons to support your view.

Application of the proposed Implementation Guidance

13 Do you agree that the proposed Implementation Guidance set out in Appendix F should be applied prospectively? Please provide reasons to support your view.

14 Do you agree that the proposed Implementation Guidance should be applied for annual reporting periods beginning on or after 1 January 2024, with earlier application permitted? Please provide reasons to support your view.

15 Do you agree that the proposed Implementation Guidance should be applicable to NFP entities in the public sector only? Please provide reasons to support your view.

General matters for comment

The AASB would also particularly value comments on the following general matters:

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

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

3 Whether, overall, the proposals would result in financial statements that would be useful to users?

4 Whether the proposals are in the best interests of the Australian economy?

5 Whether the proposals create any auditing or assurance challenges?

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

Question for Board members

Q3: Do Board members have any comments on the Introduction section of the draft ED, including the Specific Matters for Comment and General Matters for Comment?

Contents

[Draft] Australian Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows* is set out on pages 10–11. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2022-X

This [draft] Standard adds authoritative implementation guidance to AASB 13 *Fair Value Measurement* (August 2015), and related Illustrative Examples, for application by not-for-profit public sector entities.

Main features of this Standard

Main requirements

This [draft] Standard adds authoritative implementation guidance to AASB 13, and related illustrative examples, for application by not-for-profit public sector entities in respect of fair value measurements of non-financial assets not held primarily for their ability to generate net cash inflows. Specifically, this Standard clarifies that:

(a) if the market selling price of an identical asset is not directly observable, the entity maximises the use of observable inputs in measuring the fair value of the asset; however, if the entity needs to develop unobservable inputs, the entity uses its own data as a starting point and makes adjustments to those data if reasonably available information indicates that other market participants would use different data;

(b) when determining the highest and best use of such an asset, a use would be considered 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;

(c) when applying the cost approach to measure such an asset's fair value:

  (i) it is assumed that the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location;

  (ii) it is assumed that the asset subject to measurement (the subject asset) presently does not exist and all components of the asset need to be replaced. Therefore, all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date are included in the asset's current replacement cost. The subject asset's current replacement cost is measured by estimating the replacement cost of a reference asset as a starting point and adjusting for any differences between the reference asset's current service capacity and standard of finish, and those of the subject asset;

  (iii) identification of economic obsolescence is not limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity; and

  (iv) surplus capacity of an asset that is necessary for stand-by or safety purposes is not identified as representing economic obsolescence.

This [draft] Standard also requires that, 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, the appropriate level of the entity's management has committed to a plan to locate a buyer of the asset (or transfer the asset to another entity) or to use the asset for an alternative purpose.

Application date

This [draft] Standard applies to annual periods beginning on or after 1 January 2024, with early application permitted.

Question for Board members

Q4: Do Board members have any comments on the Preface section of the draft ED?

[Draft] Accounting Standard AASB 2022-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows* under section 334 of the Corporations Act 2001.

Keith Kendall

Chair – AASB

Dated … [date]

[Draft] Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows*

Objective

1 This Standard adds authoritative implementation guidance to AASB 13 *Fair Value Measurement* (August 2015), and related illustrative examples, for application by not-for-profit public sector entities and makes the related modifications to AASB 13 set out in paragraphs 5–7 below.

Application

2 The amendments set out in this Standard apply to entities and financial statements in accordance with the application of AASB 13 as set out in AASB 1057 *Application of Australian Accounting Standards.*

3 This Standard applies to annual periods beginning on or after … [1 January 2024]. This Standard may be applied to annual periods beginning before … [1 January 2024]. When an entity applies this Standard to such an annual period, it shall disclose that fact.

4 This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Amended paragraphs are shown with deleted text struck through and new text underlined. Ellipses (…) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

Amendments to AASB 13

5 Paragraphs AusC7 and AusC8 are added to Appendix C *Effective date and transition*.

Appendix C

Effective date and transition

…

AusC7 AASB 2022-X *Amendments to Australian Accounting Standards – Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows*, issued on [date], added Appendix F *Australian implementation guidance for not-for-profit public sector entities* to the previous version of this Standard. A not-for-profit public sector entity shall apply Appendix F prospectively from annual periods beginning on or after 1 January 2024. Early application is permitted.

AusC8 If an entity applies the modifications in AASB 2022-X for an earlier period it shall disclose that fact.

6 Appendix F *Australian implementation guidance for not-for-profit public sector entities* is added as set out on pages 12–18 of this Standard.

7 *Australian illustrative examples for not-for-profit public sector entities* is attached to accompany AASB 13 as set out on pages 19–20 of this Standard.

Commencement of the legislative instrument

8 For legal purposes, this legislative instrument commences on 31 December 2023.

Note 4 to Board members – Questions relating to the "Amendments to AASB 13" section

13. The questions relating to the "Amendments to AASB 13", which concern prospective application and the effective date, are included in the BC section of the draft ED.

Appendix F [FOR AASB 13]
Australian implementation guidance for not-for-profit public sector entities

This appendix is an integral part of AASB 13 and has the same authority as other parts of the Standard. The appendix applies only to not-for-profit public sector entities.

<u>Note 5 to Board members – Background to the draft IG</u>

14. As mentioned in Agenda Paper 9.2, 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: Panel meeting held on 1 December 2021 (which, due to time constraints, focused on the draft IG concerning how to identify the market participant assumptions to use in fair value measurements); and
    (b) Outreach step 2: Distributed a staff paper to targeted stakeholders on 16 December 2021 (Agenda Paper 9.5 in the supplementary folder is a copy of this paper), which included questions to stakeholders regarding the draft IG relating to the application of the cost approach.
15. Stakeholder feedback relating to market participant assumptions is noted in Agenda Paper 9.2 for this meeting. Stakeholder feedback relating to the highest and best use of an asset and the application of the cost approach is included in the notes to Board members throughout this working draft ED.
16. The questions to Board members regarding the drafting of paragraphs F3–F7 are included in Agenda Paper 9.2. Accordingly, there is no question in this paper regarding the drafting of those paragraphs.

Introduction

F1 AASB 13 *Fair Value Measurement* incorporates International Financial Reporting Standard IFRS 13 *Fair Value Measurement*, issued by the International Accounting Standards Board. Consequently, the text of AASB 13 is generally expressed from the perspective of for-profit entities. The AASB prepared this appendix to explain and illustrate the application of the principles of paragraphs 22–23, 28–29, 61, 89 and B8–B9 of the Standard by not-for-profit public sector entities, in relation to fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows. This appendix does not apply to for-profit entities or not-for-profit private sector entities or affect their application of AASB 13.

F2 This appendix should be read in conjunction with the requirements of this Standard.

Non-financial assets of not-for-profit public sector entities not held primarily for their 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.

Note 6 to Board members – Changes to the guidance on the 'financially feasible use' concept

17. AASB 13 para. 28(c) states that "A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use."

18. At its November 2021 meeting, the Board considered staff's draft NFP amendment to AASB 13 para. 28(c), which proposed including an Aus paragraph in the body of AASB 13 to explain how the 'financially feasible use' concept applies to assets held by NFP entities that are not held primarily to generate an investment return. At the time, staff proposed this paragraph: "Notwithstanding paragraph 28(c), for a non-financial asset of a not-for-profit public sector entity held primarily for its service capacity, a use is financially feasible if it generates a sufficient return – in the form of goods or services for the community – that it would be rational for market participants (including not-for-profit public sector entities) to invest in the asset's service capacity."

19. Board members broadly agreed with that proposed Aus paragraph, but requested staff to explain more clearly the concept of a 'sufficient return' in the context of the NFP public sector environment.

20. On 1 December 2021, staff obtained feedback from Panel members regarding that draft Aus paragraph quoted in paragraph 18 above. Some of them commented that:

(a) it is not evident that AASB 13 para. 28(c) requires modification, because it seems to be working well in practice; therefore, the draft modification would not be expected to affect practice. Consequently, any guidance on an asset's financially feasible use, if needed at all, should be in supporting guidance rather than an amendment to AASB 13; and

(b) the term 'community' and the phrase 'rational for market participants to invest in the asset's service capacity' in that draft paragraph need clarification.

21. After reflecting on comments provided by Board members and Panel members, staff agree that AASB 13 para. 28(c) could be applied by NFP public sector entities unamended if the IG explains how the financially feasible use concept should be applied in the NFP public sector context. Therefore, staff drafted IG paragraph F8, instead of proposing an amendment to the body of AASB 13, to assist the application of the financially feasible use concept.

22. The drafting of paragraph F8 has also been updated to explain more clearly the concept of a 'sufficient return' in the context of the NFP public sector environment and to remove reference to the term 'community'.

Note 7 to Board members – Rebuttable presumption that an asset's current use is its highest and best use

23. At the 1 December 2021 Panel meeting, all Panel members who commented on this topic supported having guidance setting out a rebuttable presumption that an asset's current use is its highest and best use (albeit they commented that this principle should not be based on whether an asset is considered specialised).

24. As noted in paragraph A11(f) of Appendix A in Agenda Paper 9.2 for this meeting, 10 of the 11 respondents to the 16 December 2021 staff paper supported having guidance stating a rebuttable presumption that an asset's current use is its highest and best use (one respondent did not comment on this topic). However, some stakeholders suggested that further clarification might be needed in identifying when an entity 'committed' to a plan to use an asset for an alternative purpose.

25. Therefore, staff drafted paragraphs F9–F10 to:

(a) remove reference to specialised assets;

(b) reflect that the presumption is rebutted only when the appropriate level of the entity's management has committed to a plan to locate a buyer of the asset (or transfer the asset to another entity) or to use the asset for an alternative purpose, and that the presumption can be rebutted even if the committed-to plan has not yet been initiated as at the measurement date; and

(c) clarify the meaning of an appropriate level of a public sector entity's management. This is because many public sector entities do not have the authority to buy or sell certain assets (e.g. land and buildings) or to use certain assets for an alternative purpose without Ministerial or Cabinet approval.

26. The rationale for proposing paragraphs F9–F10 is documented in draft paragraphs BC60–BC65.

Highest and best use (paragraphs 28–29)

F8 When applying 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.

F9 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, the appropriate level of the entity's management has committed to a plan to locate a buyer of the asset (or transfer the asset to another entity) or to use the asset for an alternative purpose. The presumption can be rebutted even if the committed-to plan has not yet been initiated as at the measurement date.

F10 Examples of the appropriate level of management of a not-for-profit public sector entity include a local government council and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government. The appropriate level of management for approving a plan to sell or redeploy an asset might depend on, for example, the asset's significance and the governance structure affecting the not-for-profit public sector entity. Identification of that appropriate level of management will depend on the circumstances.

Questions for Board members

Q5: In respect of proposed paragraph F8 regarding 'financially feasible use':

(a) Do Board members agree that the status of the guidance should be authoritative implementation guidance rather than amending requirements in the body of AASB 13; and

(b) Subject to Board members' comments on related paragraphs BC56–BC58, do Board members have any comments on the drafting of paragraph F8?

Q6: Subject to Board members' comments on related paragraphs BC60–BC65, do Board members have any comments on the drafting of paragraphs F9–F10 regarding the rebuttable presumption that an asset's current use is its highest and best use?

Note 8 to Board members – Introduction to the changes made to the IG regarding the application of the cost approach

27. Stakeholders who provided feedback on the 16 December 2021 staff paper commented that:

(a) it would be useful for the Board to provide guidance on the meaning of a 'modern equivalent asset', which is a term used by valuers when measuring the fair value of an asset by applying the cost approach;

(b) the treatment of 'removal and disposal costs for unwanted existing structures on land' and 'restoration costs' requires further clarification; and

(c) the phrase 'insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future' regarding identification of economic obsolescence, used in the draft IG considered by the Board at the November 2021 meeting, requires further clarification.

28. In light of the comments received, staff made the following changes to the draft ED regarding the application of the cost approach:

(a) added a description of a reference asset, adapted from the concept of a modern equivalent asset and a replica asset referred to in International Valuation Standard IVS 105 *Valuation Approaches and Methods*;

(b) changed the drafting of paragraph F12(b)(ii) so that restoration costs associated with restoring another entity's asset are included in the subject asset's current replacement cost only if the disrupted asset belongs to an entity outside the consolidated group (if any) to which the holder of the subject asset belongs (see Note 9 to Board members below);

(c) removed the probability threshold from the guidance on economic obsolescence (see Note 10 to Board members below); and

(d) added BC to better explain the treatment of costs of removing and disposing of unwanted existing structures on land.

29. Paragraphs BC66–BC109 reflect staff's rationale for draft paragraphs F11–F12.

<u>Note 9 to Board members – Restoration costs</u>

30. Some stakeholders who commented on the 16 December 2021 paper expressed concern that financial statements of a consolidated group would be overstated if the fair value of an asset includes the costs to restore a disrupted asset of another entity within the same consolidated group. They argued that including those costs would result in double counting the restoration costs in the consolidated financial statements for the group. This is because the consolidated financial statements would include both of the following costs used under the cost approach:

    (a) the current replacement cost (CRC) of the disrupted asset of the related entity (which is measured assuming the asset is unaffected by the disruption arising from the hypothetical acquisition or construction of the reference asset use to measure the CRC of the subject asset); and

    (b) the CRC of the subject asset, including the costs to restore the related entity's asset.

31. Staff agree with the stakeholders' concern and therefore recommend that such restoration costs should be included in the subject asset's CRC only if they relate to disruption of an asset of an entity outside the consolidated group (if any) to which the holder of the asset belongs.

32. Staff also considered the following mutually exclusive alternatives to the approach recommended in paragraph 31 for responding to the concern about double-counting restoration costs in consolidated financial statements:

    (a) excluding restoration costs from CRC estimates for all NFP public sector entities, on the grounds of simplicity; and

    (b) omitting to provide guidance on restoration costs.

33. Staff do not recommend the approach in paragraph 32(a) because feedback from some stakeholders (in particular local government) has been supportive of the draft guidance on restoration costs – consistent with local governments not being identified as entities within a consolidated group. In addition, staff do not recommend the approach in paragraph 32(b) because restoration costs are a type of 'brownfield' cost, and the Board was asked by stakeholders to provide guidance on whether 'brownfield' costs should be included in the CRC of non-financial assets of NFP public sector entities.

34. Staff acknowledge that the proposed exclusion of such restoration costs for assets of related entities within a consolidated group would depart from the conceptual principle that an individual entity's assets are accounted for by reflecting the entity's perspective (rather than the perspective of the group). A more conceptual variation of the staff recommendation in paragraph 31 would be to provide guidance that such restoration costs are included in an individual entity's financial statements where related entities within a consolidated group are affected, but eliminated on consolidation. However, in view of the cost involved in tracking such restoration costs at each measurement date, only to omit those restoration costs from the consolidated financial statements for the group, staff consider that the costs of applying that more conceptual variation would be likely to outweigh the benefits of that approach.

Application of the cost approach (paragraphs B8–B9)

F11 When measuring a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows (the subject asset) using the cost approach under paragraphs B8–B9, the entity:

(a) assumes the asset will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper location;

(b) estimates the replacement cost of the subject asset assuming that the asset presently does not exist, and uses the replacement cost of a reference asset as input. All necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date are included the subject asset's current replacement cost; and

(c) adjusts the estimated replacement cost of a reference asset for any differences between the reference asset's current service capacity and standard of finish, and those of the subject asset. A reference asset could be a modern equivalent asset or a replica asset (where the utility offered by the subject asset could be provided only, or more cheaply, by a replica rather than a modern equivalent asset). A modern equivalent asset is an asset that provides similar function and equivalent utility to the subject asset, but which is of a current design and constructed or made using current cost-effective materials and techniques.

F12 For the purposes of paragraph F11(b), the entity:

(a) includes once-only costs in the replacement cost of the subject asset, that is, costs of parts of an asset not expected to actually be replaced in the future (because they are not expected to wear out) but that would need to be incurred in a hypothetical acquisition or construction of the subject asset assuming it does not presently exist;

(b) applies judgment in the circumstances of the subject asset to determine whether the following costs would (among other costs) need to be incurred upon the hypothetical acquisition or construction of the subject asset at the measurement date:

(i) costs of removal and disposal of any unwanted existing structures on land that would hypothetically be incurred unavoidably when acquiring or constructing the subject asset at the measurement date; and

(ii) any disruption costs that would hypothetically be incurred, when acquiring or constructing the subject asset at the measurement date, including costs of restoring the assets of another entity outside the consolidated group (if any) to which the holder of the subject asset belongs; and

(c) uses the costs necessarily incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than using only the cheapest legally permitted costs to the entity. For example, where replacement of the surface of a road would necessarily, in the ordinary course of operations, occur at night rather than during daytime to minimise disruption to drivers, the more costly night-time costs should be included in the asset's current replacement cost rather than the lower daytime costs. This would occur when it is necessary for the entity to incur the higher night-time cost, that is, if replacement of the surface of the road in the daytime would be incompatible with the entity's required continuity of service.

Question for Board members

Q7: Subject to Board members' comments on related paragraphs BC75–BC109:

(a) Do Board members agree with paragraph F12(b)(ii) that restoration costs associated with restoring another entity's asset should be included in the subject asset's CRC only if the disrupted asset belongs to an entity outside the consolidated group (if any) to which the holder of the subject asset belongs?

(b) Do Board members have any comments on the drafting of paragraphs F11–F12 regarding the nature of costs included in current replacement cost?

Note 10 to Board members – Changes to the draft IG regarding economic obsolescence

35. At its November 2021 meeting, the Board considered an earlier version of paragraph F14, which stated:

"When an asset described in paragraph F13 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." [emphasis added]

36. Some Board members and stakeholders (who provided feedback on the 16 December 2021 staff paper) commented that more guidance would be needed to explain better the meaning of 'insignificant chance' or 'significant chance' because Australian Accounting Standards do not define the term 'significant'. Some stakeholders recommend using the term 'probable' instead of 'insignificant chance' or 'significant chance'.

37. Staff consider that applying a 'probable' threshold could involve greater cost and effort for preparers and auditors of financial statements, because it could be more exacting to apply. In addition, an asset's standby capacity is held because of the variability and uncertainty in demand for the asset's services, and this is a qualitative aspect that can defy quantification. That is, it would often be very difficult to estimate in advance the frequency and extent to which the standby capacity would be called upon.

38. Therefore, staff consider that it might be more appropriate to propose IG on economic obsolescence in the ED that excludes any probability threshold regarding possible future increases in demand for the asset's services.

39. Staff observe that paragraph AG21 of the NZASB's Application Guidance added to PBE IPSAS 17 *Property, Plant and Equipment* did not include a probability threshold when identifying external obsolescence. It states that "No obsolescence adjustment is made in respect of surplus capacity that, while rarely or never used, is necessary for stand-by or for safety purposes."

40. Staff have updated paragraphs F14 and F15 to use wording consistent with that in paragraph AG21 of NZASB's PBE IPSAS 17.

Economic obsolescence

F13 When a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows has suffered a reduction in demand for its services, the identification of 'external (i.e. economic) obsolescence' (referred to in paragraph B9) does not require a formal decision to have been made to reduce the physical capacity of that asset.

F14 When an asset described in paragraph F13 apparently has surplus capacity in view of current demand for its services, economic obsolescence is not identified for that asset if that 'surplus capacity' is necessary for stand-by or safety purposes (e.g. to deal with contingencies), even if it seldom or never is actively utilised.

F15 An example of where economic obsolescence of an asset would be identified when applying the principles in paragraphs F13–F14 is a public school building that has a capacity for 500 students but, due to demographic changes, a school for 100 students would meet current and reasonably foreseeable requirements, including a buffer needed for any temporary or underestimated student demand. In this example, the school building's gross replacement cost would be based on the school's needed capacity (for 100 students), from which any other accumulated obsolescence related to the condition of the school building (e.g. physical obsolescence) would be deducted. Consistent with paragraph F13, this would be the case regardless of whether a formal decision has been made to reduce the school building's capacity.

Question for Board members

Q8: Subject to Board members' comments on related paragraphs BC124–BC131:

(a) Do Board members agree that a probability threshold should not be included regarding possible future increases in demand for the asset's services (or when surplus capacity should cease to be considered standby capacity)?

(b) Do Board members have any comments on the drafting of IG paragraphs F13–F15?

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.

Fair value of a non-financial asset not held primarily for its ability to generate net cash inflows and measured under the cost approach

IE2 Examples 1 and 2 illustrate the costs included in the current replacement cost (before deducting obsolescence) of a non-financial asset not held primarily for its ability to generate net cash inflows under the cost approach in paragraphs B8–B9 and F11–F12.

Example 1 – Costs included in the current replacement cost of a road

A local government (Council A) measures its roads at current replacement cost as their estimated fair value. Council A applies the revaluation model after recognition of each class of property, plant and equipment, as referred to in paragraph 31 of AASB 116 *Property, Plant and Equipment*.

Council A recognises land under roads as a separate class of asset, the valuation of which is not addressed in this example.

Year ending 30 June 20X2

As at 30 June 20X2, Council A controls a new road to which the following costs (measured using prices as at that measurement date) relate. Council A assesses whether each of these costs should be included in the road's current replacement cost (before deducting obsolescence) as at the measurement date.

In this example, it is assumed that the construction of the road subject to measurement occurred within a year and, consequently, in the current market environment, material financing costs (from the perspective of the market participant) were not incurred.

	Estimated cost as at 30 June 20X2
	$'000
Design work	2,200
Earthworks	10,000
Formation	5,000
Pavement	3,000
Surfacing	2,000
Disruption of traffic (traffic control and detour costs)	1,000
Total	23,200

Council A's road is situated in a densely populated area, and when the road was constructed, there were no vacant sites in the surrounding area. Consequently, Council A needed to acquire land with unwanted existing structures and incurred a cost of $1,000,000 to remove those structures. Council A assesses that, to construct the road in a hypothetical acquisition, a market participant buyer would also need to incur a similar cost (which it estimated to be unchanged at $1,000,000 as at 30 June 20X2).

Current replacement cost considerations as at 30 June 20X2

Once-only costs

In accordance with paragraphs F11–F12, Council A concludes that each of the estimated costs listed above (which total $23,200,000) should be included in the road's current replacement cost because that measure assumes that the road asset presently does not exist and all components of the road, including the once-only earthworks and formation works, would need to be undertaken in a hypothetical replacement of the road at the measurement date. This is because the cost to a market participant buyer to acquire or construct a substitute road of comparable utility at the asset's existing location would include each of those costs, including any intrinsically linked disruption costs (i.e. traffic control and detour costs).

Costs of removal and disposal of unwanted existing structures

In addition, Council A includes the estimated costs of removal and disposal of unwanted existing structures at $1,000,000 as at 30 June 20X2 in the road's current replacement cost. This is because it is reasonable to expect that a market participant buyer would need to incur such costs if it was to construct a substitute road at the asset's existing location since there is no vacant land available in the area.

Consequently, Council A measures the road's current replacement cost (before deducting obsolescence) as at 30 June 20X2 as $24,200,000 (i.e. $23,200,000 + $1,000,000).

Example 2 – Change in the asset's operating environment affecting the current replacement cost of a road after its initial fair value measurement

In this example, the facts of Example 1 apply, and it is also assumed that:

- during the year ending 30 June 20X3 another entity's drainage works were installed under the road;
- Council A determines that, if its road was to be replaced as at the measurement date of 30 June 20X3, the other entity's drainage works would be disrupted;
- the current costs required to restore those drainage works disrupted during the hypothetical replacement of the components of Council A's road (i.e. another type of intrinsically linked disruption cost) is $2,500,000;
- Council A is not part of a group of entities that prepares consolidated financial statements;
- none of the replacement costs as at 30 June 20X2 changed during the year ending 30 June 20X3 (for simplicity); and
- the effect of depreciation of the road for the year ending 30 June 20X3 is ignored (for simplicity).

Current replacement cost considerations as at 30 June 20X3

Restoration costs for surrounding assets of another entity

In addition to the unchanged replacement cost estimate of $24,200,000 for the components of that cost existing at 30 June 20X2, Council A also includes in the road's current replacement cost the $2,500,000 restoration costs for the drainage works necessarily disrupted during hypothetical replacement of the road's components.

This is because the cost to a market participant buyer to acquire or construct a substitute road at the current location would necessarily include those restoration costs. In addition, because Council A is not part of a group of entities that prepares consolidated financial statements, the 'same group' scope exclusion for such costs in paragraph F12(b)(ii) does not apply to Council A.

Consequently, as at 30 June 20X3, Council A measures the road's current replacement cost (before deducting obsolescence) as $26,700,000 (i.e. $24,200,000 + $2,500,000). Ignoring the effect of depreciation of the road for the year ending 30 June 20X3, this represents an increase of $2,500,000 in the road's carrying amount, which is recognised as a revaluation increase in accordance with paragraphs 39–Aus39.1 of AASB 116.

As at 30 June 20X2, Council A did not anticipate in its financial statements the cost of $2,500,000 to restore another entity's drainage works. This is because the operating environment of the road as at 30 June 20X2 did not require incurring the restoration cost if the road were replaced as at 30 June 20X2. In contrast, the change in the operating environment of the road during the year ending 30 June 20X3 – that is, the installation of new drainage works under the road – caused such restoration costs to be necessarily incurred if Council A's road was hypothetically replaced as at 30 June 20X3.

Question for Board members

Q9: Do Board members have any comments on the draft Illustrative Examples?

Note 11 to Board members – Introduction to the BC section

41. Agenda Paper 3.2 for the Board's November 2021 meeting included draft text for some sections of the BC. However, most of those draft BC paragraphs were not discussed at the November 2021 meeting. For ease of reference, key changes made to those BC paragraphs since the November version reviewed by the Board are marked up, with deleted text struck through in ~~red text~~ and new text underlined in blue text.

42. New BC sections that the Board has not yet reviewed are shaded in green.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 2022-X Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities Not Held Primarily to Generate Net Cash Inflows.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Exposure Draft (ED). It sets out the reasons why the Board developed the ED, the approach taken to developing the ED and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for undertaking the 'Fair Value Measurement for Not-for-Profit Public Sector Entities' Project

Majority of non-financial assets in the public sector are measured at fair value

BC2 The Financial Reporting Council (FRC) issued a direction to the AASB to require the Whole of Government (WoG) and the General Government Sector (GGS) to harmonise with Government Finance Statistics (GFS) requirements. Consequently, AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires each WoG and GGS to elect an accounting treatment that aligns with GFS principles and requirements where an accounting standard permits a choice (AASB 1049 para. 13). Because GFS requires assets and liabilities to be measured at current market value, this has resulted in each WoG and GGS electing to apply the revaluation model as their accounting policy and measure their non-financial assets, such as property, plant and equipment, at fair value under AASB 13 *Fair Value Measurement*.

BC3 Although AASB 1049 requires only WoG and GGS to align with GFS principles, some stakeholders from the public sector have informed the Board that the Treasury or Finance Department (or other authority) and the Office of Local Government in each jurisdiction has issued instructions to require the other public sector entities in their jurisdiction to also elect the accounting treatments that align with GFS principles, which has led to the majority of non-financial assets of public sector entities being measured at fair value.

Diversity and inconsistency in applying the requirements of AASB 13

BC4 The Board initially considered the application of AASB 13 for not-for-profit and public sector entities in 2011 when IFRS 13 *Fair Value Measurement* was issued. At its March and June 2011 meetings, the Board decided not to include any not-for-profit entity modifications to IFRS 13 in AASB 13. At that time, the Board considered that even though many non-financial assets in the public sector might have a specialised nature or that observable market inputs might not be readily available, a public sector entity would be able to measure the fair value of such assets at current replacement cost, under the cost approach in IFRS 13.

BC5 At its December 2014 meeting, the Board considered feedback from stakeholders regarding the application of AASB 13. The Board decided to undertake a narrow-scope project to give relief from certain AASB 13 disclosures, limited to items of property, plant and equipment within the scope of AASB 116 *Property, Plant and Equipment* that are held primarily for their current service capacity rather than primarily to generate future net cash inflows, in relation to disclosure of quantitative and qualitative information about the significant unobservable inputs used in the fair value measurement of such assets. This project resulted in AASB 2015-7 *Amendments to Australian Accounting Standards — Fair Value Disclosures of Not-for-Profit Public Sector Entities*.

BC6 During the due process of developing AASB 2015-7 and consideration of ITC 34 *AASB Agenda Consultation 2017–2019* (in which the Board sought views on the AASB's priorities for its work program for the period 2017–2019), some stakeholders in the public sector asked the Board to provide guidance clarifying how to apply the requirements in AASB 13 to the fair value measurement of public sector entity assets.

BC7 Many stakeholders in the public sector commented that applying AASB 13 had been challenging and costly. They requested guidance on how to measure the fair value of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, in particular (but not limited to):

(a) the market participant assumptions to use in measuring fair value where a public sector entity's asset has few or no market participants (other than the holder of the asset) and where information about market participants' inputs to a current replacement cost model may be scarce;

(b) how government-imposed public-sector-specific restrictions on non-financial assets should be taken into account;

(c) how to measure the fair value of public sector entity assets using the cost approach; and

(d) the concept of obsolescence under the cost approach.

BC8 The Board was advised that the measurement issues are pervasive in the not-for-profit public sector and involve divergence in practice.

BC9 In addition, in considering its Service Concession Arrangements: Grantors project, the Board decided at its February 2016 meeting that, because a service concession asset is an asset that the grantor uses for its service potential to achieve public service objectives (rather than to generate net cash inflows), only the cost approach to measuring fair value is relevant and, where the operator has been granted the right to future cash flows, this need not be considered in the measurement of the grantor's service concession asset. When developing AASB 1059 *Service Concession Arrangements: Grantors*, the Board noted that it has not provided guidance on the measurement of service concession assets on the grounds that this would best be developed in a future project on the measurement of public sector assets – the Fair Value Measurement for Not-for-Profit Public Sector Entities Project (FVM project).

Fair Value Project Advisory Panel and outreach activities in developing the Exposure Draft

BC10 The Board established the Fair Value Project Advisory Panel (the Panel) to provide a forum for the Board to consult on specific fair value measurement issues. The Panel consists of industry experts with experience in dealing with fair value measurement issues, and includes asset valuers and financial statement preparers and auditors. The Board held several meetings with the Panel over the course of the project. The FVM project has been assisted considerably by extensive input from Panel members.

BC11 As part of the FVM project, the Board also consulted with some asset valuers and the Australian Valuation Standards Committee to seek understanding of how asset valuations are carried out in practice, and whether (and, if so, in what manner) the principles in AASB 13 differ from these practices.

Stakeholder feedback on the IPSASB's Measurement project

BC12 In April 2021, the International Public Sector Accounting Standards Board (IPSASB) issued Exposure Draft ED 77 *Measurement*. If approved, ED 77 would establish a single comprehensive Standard that identifies and defines the measurement bases used in IPSAS for not-for-profit public sector entities.

BC13 ED 77 was developed based on the view that the fair value measurement basis under IFRS 13 (which is adopted in AASB 13) would be applicable to assets held for their financial capacity, but would be inappropriate for measuring the current value of assets held for their operational capacity (i.e. assets not held primarily for their ability to generate net cash inflows). Instead, the IPSASB proposed a different current value measurement basis – current operational value – for measuring the current value of assets held for their operational capacity.

BC14 In contrast with fair value, which is a market-participants-based exit value reflecting an asset's highest and best use, current operational value is proposed to be an entity-specific entry value based on an asset's existing use. The IPSASB proposed that the same three measurement techniques – the market, income and cost approach – would be applicable in estimating both:

(a) an asset's fair value, for assets held primarily for their financial capacity; and

(b) an asset's current operational value, for assets held primarily for their operational capacity.

BC15 In accordance with paragraph 20 of *The AASB's Approach to International Public Sector Accounting Standards* (October 2019), in May 2020 the Board issued 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, to obtain Australian stakeholders' views on the IPSASB's proposals.

BC16 The Board added AASB Specific Matters for Comment in ITC 45 to specifically obtain views on whether Australian stakeholders would prefer that the Board adopts, in respect of current value measurement of non-financial assets of not-for-profit entities not held primarily for their ability to generate net cash inflows, the IPSASB's proposed current operational value measurement basis or continues applying the fair value measurement basis.

BC17 The Board received six comment letters on ITC 45. Based on those comment letters and on the feedback received from related outreach activities, the Board noted that a significant majority of stakeholders that responded to ITC 45, including not-for-profit public sector entities' financial statement preparers, auditors and valuers, indicated that fair value under AASB 13 is appropriate for measuring the current value of all non-financial assets held by not-for-profit public sector entities, whether held primarily for their financial capacity or operational capacity, and should remain the sole current value measurement basis.

BC18 The majority of these stakeholders also commented that they agree with applying the 'highest and best use' and 'market participants' concepts under fair value for measuring the current value of non-financial assets not held primarily for their ability to generate net cash inflows, although some stakeholders have sought the Board's guidance to assist entities to understand better how these concepts should be applied in the not-for-profit public sector context. They considered that applying the fair value basis to all non-financial assets, despite the need to exercise judgement in applying those concepts, would be preferable to applying two measurement bases, as proposed in the IPSASB's Exposure Drafts. This is because it would avoid:

(a) the need for financial statement preparers, auditors and valuers to understand the requirements of two measurement bases;

(b) imposing potential additional costs and effort to assess which measurement basis is appropriate for each asset or class of assets, or to reassess the appropriate measurement basis when there is a change in how an entity uses an asset; and

(c) reporting to users of financial statements of not-for-profit public sector entities current values based on mixed measurement bases, which would reduce the comparability and understandability of the totals reported.

Reasons for developing the Exposure Draft

BC19 The Board considered the comments received on ITC 45 and decided to propose that the fair value measurement basis should continue to be applied when measuring the current value of all non-financial assets of not-for-profit public sector entities, including those that are not held primarily for their ability to generate net cash inflows.

BC20 Accordingly, the Board proceeded to develop additional guidance to assist not-for-profit public sector entities to apply the principles of AASB 13 more consistently in measuring their non-financial assets not held primarily for their ability to generate net cash inflows, in addressing the stakeholders' requests noted in paragraph BC7. Another key purpose of developing additional guidance is to enable application of AASB 13 in a more cost-effective manner by clarifying its application, including clarifying the extent to which preparers of financial statements need to search for information in the absence of observable market inputs.

BC21 The Board decided to propose implementation guidance to assist the application of the following principles in measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows:

(a) the market participant assumptions to use;

(b) the circumstances in which the presumption that the asset's current use is its highest and best use would be rebutted;

(c) the 'financially feasible use' aspect of highest and best use (AASB 13 para. 28(c)); and

(d) how to measure the current replacement cost of such a non-financial asset, including the nature of component costs belonging in that amount, the factors to consider in identifying economic obsolescence, and whether current replacement cost should be measured assuming the asset's replacement occurs in its present location.

Question for Board members

Q10: Do Board members have any comments on draft paragraphs BC1–BC21 regarding the history of the FVM project?

Note 12 to Board members – BC relating to paragraphs F3–F7

43. Staff's draft BC paragraphs explaining draft IG paragraphs F3–F7, regarding market participant assumptions about a non-financial asset not held primarily for its ability to generate net cash inflows, are set out in draft paragraphs BC22–BC35.

Market participant assumptions about a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs 22–23, 61, 89 and F3–F7)

BC22 Consistent with IFRS 13, when measuring the fair value of an asset under AASB 13, the objective is to estimate an exit price from the perspective of a market participant for the asset at the measurement date. Therefore, fair value assumes that a market participant's assumptions when pricing an asset are identifiable.

BC23 Some stakeholders expressed the view that, in some cases, a market participant for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is not readily identifiable. This is because the services provided by such an asset sometimes are unique; and therefore, they argued that:

(a) there would not be a private sector entity, another government or another not-for-profit public sector entity that would provide such services; and, in turn,

(b) there would not be another identifiable market participant for many assets held by not-for-profit public sector entities. Therefore, the market selling price of many such assets, or of an identical asset, is unlikely to be directly observable.

BC24 In this respect, the Board noted that AASB 13 para. 23 states that an entity need not identify specific market participants, reflecting the focus of AASB 13 para. 22 on the **assumptions** that market participants would use when pricing the asset. In addition, the Board noted that, when the market selling price of an identical asset is directly observable, the entity does not need to consider what those market participant assumptions would be, because that price incorporates implicitly the assumptions that market participants would use.

BC25 When the market selling price of an identical asset is not directly observable, the entity would need to explicitly estimate the pricing assumptions that market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

BC26 In light of the stakeholder comment that many non-financial assets of not-for-profit 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 such unique assets), staff consider that the holder of such unique assets (such as those assets listed in paragraph F7) would need to develop at least some unobservable inputs in order to measure the fair value of those assets.

BC27 AASB 13 para. 89 (in relation to developing unobservable inputs) states that: "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." [emphasis added]

BC28 AASB 13 para. 89 limits the use of an entity's own data to where the inputs are unobservable. In relation to applying the principle noted in paragraph BC25, the Board proposes to:

(a) extend the requirements of AASB 13 para. 89 so that an entity's own data is required to be used at a starting point if some relevant information about market participant assumptions needed to estimate the fair value of the asset is not reasonably available;

(b) retain the requirement for a not-for-profit public sector entity to adjust its own 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 (e.g. an entity-specific synergy). This would preclude an entity from using its own unadjusted data where those data are inconsistent with reasonably available information about the inputs that market participants (e.g. other not-for-profit public sector entities, such as other local governments) would use in pricing the asset; and

(c) replicate the statement in AASB 13 para. 89 that an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.

BC29 The Board considers that the simplification of AASB 13 para. 89 described in paragraph BC28 would 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 not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. This is because:

(a) 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) if the market selling price of an identical asset is not directly observable, but 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 fair value of the asset (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) if no relevant information about the assumptions of other market participants needed to estimate the fair value of the asset is reasonably available, the entity would use its own data to estimate the fair value of the asset without the need to incur exhaustive efforts to identify market participant data.

BC30 Therefore, in accordance with paras. 24(a)(iii) and 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*, the Board considered there would be merit in simplifying AASB 13 para. 89 to avoid undue cost and effort required to identify the market participant assumptions to use in measuring such assets.

Specialised assets considerations

BC31 Since most stakeholders' requests for guidance on fair value measurement pertain to non-financial assets that either have limited market inputs, or are specialised, or both, the Board considered whether to provide guidance on identifying the market participant assumptions to use when measuring specialised assets only, rather than providing guidance more broadly on all non-financial assets not held primarily for their ability to generate net cash inflows.

BC32 The Board decided not to provide guidance limited to specialised assets because:

(a) the application of AASB 13 should not be based on the nature of the asset, in view of AASB 13 providing a fair value hierarchy focused on the nature and extent of observable inputs; and

(b) it would be difficult to clearly distinguish specialised assets from other assets.

Other considerations

BC33 The Board considered, but rejected, providing guidance on market participant assumptions based on whether a market participant other than the holder of the asset is readily identifiable for a non-financial asset, and on identifying the entity likely to be the highest bidder for the asset subject to measurement in a hypothetical sale.

BC34 The Board made this decision after considering comments received from stakeholders in targeted outreach that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are not sold regularly and may not have market participants other than the holder of the asset. Two main concerns were raised by stakeholders regarding the approach described in paragraph BC33, namely that:

(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).

BC35 Simplifying AASB 13 para. 89 in the manner described in paragraphs F4–F6 would address these two key concerns raised by stakeholders.

Question for Board members

Q11: Do Board members have any comments on draft BC22–BC35 regarding the draft IG on market participant assumptions?

Note 13 to Board members – BC regarding the general principles for applying the highest and best use concept

44. As noted in Section 1 in Agenda Paper 3.2 for the November 2021 meeting, the Financial Reporting and Accounting Committee (FRAC) of the Australasian Council of Auditors General (ACAG) requested guidance regarding the 'physically possible', 'legally permissible' and 'implied restrictions' considerations in order to identify the highest and best use of a non-financial asset. Those requests and the related staff analysis are set out in draft paragraphs BC36–BC55.

45. Only minor changes were made to the draft BC on this topic considered by the Board at its November 2021 meeting, as shown in marked-up text below.

Identifying the highest and best use of a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs 28–29)

General principles regarding physical constraints and legal restrictions

BC36 As stated in AASB 13 para. 22, fair value measurement of an asset is based on the assumptions that market participants would use when pricing the asset. Specifically, when identifying the highest and best use of an asset:

(a) AASB 13 para. 28(a) requires consideration of the physical characteristics of the asset that market participants would take into account when pricing the asset. This would include any physical constraints or impediments that a market participant would take into account when pricing the asset (e.g. contamination of a property); and

(b) AASB 13 para. 28(b) requires consideration of any legal restrictions on the use of the asset that market participants would take into account when pricing the asset. Similarly, as noted in paragraph BC37, the IASB's Illustrative Examples accompanying IFRS 13 demonstrate that a restriction over the use of an asset should be taken into account in a fair value measurement of that asset if, and only if, the restriction would transfer to market participants in a hypothetical sale transaction. When the restriction would transfer to market participants in a hypothetical sale transaction, it is regarded as a characteristic of the asset that market participants would take into account when pricing the asset.

BC37 Para. IE29 of the Illustrative Examples accompanying IFRS 13 provides the following example: "A donor contributes land in an otherwise developed residential area to a not-for-profit neighbourhood association. The land is currently used as a playground. The donor specifies that the land must continue to be used by the association as a playground in perpetuity. Upon review of relevant documentation (eg legal and other), the association determines that the fiduciary responsibility to meet the donor's restriction would not be transferred to market participants if the association sold the asset, ie the donor restriction on the use of the land is specific to the association. Furthermore, the association is not restricted from selling the land. Without the restriction on the use of the land by the association, the land could be used as a site for residential development. In addition, the land is subject to an easement (ie a legal right that enables a utility to run power lines across the land)."

BC38 Consistent with the IASB's analysis in the illustrative example quoted in paragraph BC37, the Board noted that the fair value measurement of an asset:

(a) would not take into account a restriction that is specific to the entity holding the asset, i.e. would not transfer to market participants in a hypothetical sale transaction (e.g. the restriction on the use of land in the IASB's example); but

(b) would take into account the effect of restrictions that would transfer to market participants in a hypothetical sale transaction (e.g. the easement restriction in the IASB's example).

Physically possible

BC39 Stakeholders requested guidance regarding whether, and if so how, physical constraints should be considered when measuring an asset's fair value. These physical constraints can be:

(a) naturally occurring, for example land under water (e.g. marine parks) and old growth forests (e.g. national parks), where both examples are of assets that are not readily replaceable or cannot be relocated to an alternative location; and

(b) the result of the entity's activities, for example:

(i) land that has been used as a council garbage tip, where the resulting risk of methane emissions might limit the land's potential uses to only being suitable for conversion to parkland; and

(ii) cemetery land, where the issue is not only the legal restriction for use as a cemetery but involves human remains that cannot be moved to ~~a cheaper~~ another location should the entity be required to 'replace the service potential' embodied in the cemetery.

Naturally occurring physical constraints

BC40 The Board concluded that a naturally occurring physical constraint leading to an inability in practice (rather than hypothetically) to replace or relocate the asset, such as a marine park, does not of itself preclude measuring the asset at fair value because a fair value measurement assumes a hypothetical transaction.

BC41 However, for some marine parks and old growth forests there might be insufficient market data available to enable reliable estimates of the asset's fair value. The Board noted that AASB 116 *Property, Plant and Equipment* para. 31 specifies that for an asset to be subsequently measured at a revalued amount, the fair value of the asset must be able to be measured reliably.

Physical constraints resulting from the entity's activities

BC42 The Board noted that some activities of the entity, such as using a parcel of land as a garbage tip, affect the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. using land as a garbage tip would limit the physically possible use of the land ~~that is physically possible~~, as referred to in AASB 13 para. 28(a)).

BC43 In the case of cemetery land, even if the land were not legally restricted to being used only as a cemetery, the number of plots used for interred human remains would affect the cash-generating ability of the cemetery land because it reduces the number of remaining plots that a market participant could sell. This would be considered in measuring the fair value of cemetery land by reference, directly or indirectly, to the land's ability to generate net cash inflows or income.

BC44 The Board considered that any specific guidance regarding how physical constraints should be considered in estimating the fair value of an asset does not belong in principles-based Australian Accounting Standards.

Prohibitions on sale

BC45 AASB 13 para. 28(b) is silent regarding whether prohibitions on the sale of an asset are to be considered in identifying an asset's highest and best use; that paragraph only specifies that certain restrictions on the *use* of asset should be taken into account when identifying an asset's highest and best use. Some stakeholders requested guidance on the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows that the entity is prohibited from selling, and how that prohibition should be taken into account in measuring the asset's fair value.

BC46 The Board noted that the fair value of an asset is based on a hypothetical sale transaction, notwithstanding any prohibition on the asset's sale. The restrictions taken into account when determining an asset's highest and best use are those that transfer upon the asset's sale to the hypothetical market participant. Therefore, a prohibition on sale of such an asset is not a factor in the determination of its highest and best use, and consequently should be disregarded when measuring the asset's fair value.

Restrictions on use

BC47 Some stakeholders also requested guidance regarding restrictions relating to caveats attached to land, such as where biodiversity rights have been sold through a biodiversity scheme and the land cannot be used for another purpose. The Board considered that if the caveats would remain attached to the land upon its sale to a market participant, such caveats should be considered in identifying the asset's highest and best use.

BC48 The Board also noted that International Valuation Standard IVS 104 *Bases of Value* (effective 31 January 2022) para. 140.5(b) states that the determination of an asset's highest and best use involves consideration of the likelihood that any legal restrictions on the use of the asset (e.g. town planning/zoning designations) will change. The Board considered that, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, consideration of the likelihood that any legal restrictions on the use of the asset will change should occur in the context of the current social-political environment.

'Implied restrictions' on an asset's use

BC49 Some stakeholders have informed the Board that sometimes a non-financial asset of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows, although not subject to any legal restrictions, is subject to an 'implied restriction' limiting the asset's use to its existing use – that is, where there is no legal restriction imposed on the asset but, because of ~~community expectation~~ social or political expectations or other factors, the not-for-profit public sector entity holding the asset would be unable to use the asset for an alternative use.

BC50 Those stakeholders consider that those assets with implied restrictions would never be sold by the entity holding them because of the legal mandates applying generally to the not-for-profit public sector entity. Therefore, they consider that the entity can only use those assets for their existing use. They argued that implied restrictions over the use of an asset should be treated as substantially the same as legal restrictions referred to in AASB 13 para. 28(b) in identifying the highest and best use of the asset when measuring the asset's fair value.

BC51 The Board decided that the general principles in AASB 13, as described in paragraph BC36, are sufficient in determining the highest and best use of an asset subject to implied restrictions – that is, the highest and best use of an asset takes into account physical characteristics of the asset that market participants would take into account when pricing the asset, and legal restrictions on use that would be transferred to market participants in a hypothetical sale transaction. Any guidance that is different to this principle would be a departure from AASB 13.

BC52 ~~The Board also noted that if an asset subject to implied restrictions on use is specialised, in accordance with paragraph F9, 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 specialised asset for an alternative purpose.~~

Public-sector-specific restrictions on prices that can be charged

BC53 Consistent with the Board's view noted in paragraph BC51, legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset not held primarily for its ~~service capacity~~ ability to generate net cash inflows that would not be transferred to market participants are not considered in fair value measurement of the asset. The Board observed that, in various cases, such legal restrictions on prices that can be charged are entity-specific restrictions (i.e. restrictions that are not expected to transfer to market participant buyers).

BC54 For example, a not-for-profit public sector entity operating a public hospital may have legal restrictions on the price it may charge for providing health services. Those pricing restrictions would be assumed not to transfer to market participants if a private sector buyer of a hospital facility would not be subject to those pricing restrictions. In this case, the fair value measurement of the hospital facility would not take into account those pricing restrictions, because they would not transfer to market participants.

BC55 Similarly, a not-for-profit public sector entity might in effect (but not legally) impose a restriction on the prices it charges for the use of one of its assets. For example, a city council might provide car parking at below-market prices to provide enhanced access (and entice more visitors) to the city centre. Because a market participant buyer in a hypothetical sale of the city council's car park would not be restricted to providing car parking at below-market prices, it would price the city council's car park without regard to the discounts currently provided to patrons. Therefore, the fair value estimate of the car park should not be reduced (compared with the value determined for a for-profit entity) because of a self-imposed restriction to charge below-market prices for the use of car spaces.

Question for Board members

Q12: Do Board members have any comments on draft paragraphs BC36–BC55?

Note 14 to Board members – BC regarding paragraph F8

46. The marked-up changes in paragraphs BC56–BC58 indicate changes made to the draft BC on the 'financially feasible use' issue considered by the Board at its November 2021 meeting.

Financially feasible use (paragraph F8)

BC56 The Board has also been asked to clarify the application of 'financially feasible use' in AASB 13 para. 28(c) to non-financial assets of not-for-profit public sector entities not held primarily for their ~~service capacity~~ ability to generate net cash inflows, ~~particularly~~ because those assets are not held primarily to ~~generate net~~

~~cash inflows or~~ produce an investment return. AASB 13 para. 28(c) refers to an asset's use that "generates adequate income or cash flows … to produce an investment return …".

BC57 The Board concluded that, although the principle of an asset's use being 'financially feasible' should apply to fair value measurements of any non-financial asset, for an asset of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows, AASB 13 para. 28(c) should be clarified in terms relevant to the not-for-profit public sector environment.

BC58 The Board considered that adding the ~~amendment in paragraph Aus28.1~~ guidance in paragraph F8 is necessary to avoid the risk that AASB 13 para. 28(c) is interpreted to preclude measuring the fair value of a non-financial asset not held primarily for its ~~service capacity~~ ability to generate net cash inflows at an amount exceeding the present value of cash inflows generated directly by the asset. Such an interpretation could result in measurements that do not reflect faithfully the service potential embodied in those assets for which market participants would be prepared to pay in a hypothetical sale transaction. The Board noted that for many assets not held primarily for their ~~service capacity~~ ability to generate net cash inflows, their fair value would be measured at current replacement cost (under the cost approach), and although these assets often generate considerable cash inflows through 'indirect' sources, such as appropriations and grants, ~~but~~ these cash inflows typically would not be included in assessments of 'investment returns' such as the cash inflows used in applying the income approach.

BC59 ~~In the context of a non-financial asset of a not-for-profit public sector entity held primarily for its service capacity, the Board considers that a market participant's ability to generate economic benefits is not limited to the amount of net cash inflows it could generate directly (e.g. user charges), but also includes the following potentially overlapping benefits:~~

~~(a) the net cash inflows that the asset could generate indirectly through financial support (e.g. in the form of rates, taxes, grants and appropriations); and~~

~~(b) the ability to use the asset to provide needed goods or services to beneficiaries.~~

Question for Board members

Q13: Do Board members have any comments on draft paragraphs BC56–BC58 regarding 'financially feasible use'?

Note 15 to Board members – BC regarding the draft IG on highest and best use

47. Staff's draft BC paragraphs explaining draft IG paragraphs F9–F10 (regarding the rebuttable presumption that an asset's current use is its highest and best use, for an asset not held primarily for its ability to generate net cash inflows) are set out in draft paragraphs BC60–BC65. Paragraphs BC60–BC65 are new and therefore are shaded rather than marked up.

The highest and best use of an asset not held primarily for its ability to generate net cash inflows (paragraphs F9–F10)

BC60 Regarding the determination of whether the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows would be the asset's existing use, the Board is generally of the view that the following IASB text provides adequate guidance:

(a) IFRS 13 para. 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; and

(b) IFRS 13 para. BC71 states that: "IFRS 13 does not require an entity to perform an exhaustive search for other potential uses of a non-financial asset if there is no evidence to suggest that the current use of an asset is not its highest and best use … the IASB concluded that in many cases it would be unlikely for an asset's current use not to be its highest and best use after taking into account the costs to convert the asset to the alternative use."

BC61 However, despite that IASB text, some stakeholders requested the Board to provide additional guidance about the highest and best use of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. These stakeholders do not consider the cost incurred to search for possible alternative uses of such an asset is justified when such an asset is very unlikely to be used by market participants for a use other than its current use (because the public sector holder of the asset is likely to continue using the asset to provide services). The Board considered the request and decided to provide the implementation guidance set out in paragraphs F9–F10.

BC62 The current use presumption of an asset is rebutted only if there is evidence that, at the measurement date, the appropriate level of management of the entity has committed to a plan to sell the asset (or to transfer the asset to another entity) or to use the asset for an alternative purpose. The Board considered that if an entity has committed to a plan to sell the asset or to use an asset for an alternative use, the entity would have considered the alternative use to be financially feasible, as well as physically possible and legally permissible. In this case, the highest and best use of that asset would be the planned alternative use. This is because an entity would only commit to a plan to use an asset for an alternative use if that use would maximise the value of the asset.

BC63 The Board noted that the appropriate level of management of a not-for-profit public sector entity would include a local government council and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government. The appropriate level of management for approving a plan to sell or redeploy an asset might depend on, for example, the asset's significance and the governance structure affecting the not-for-profit public sector entity. Identification of that appropriate level of management will depend on the circumstances.

Interaction with AASB 5 Non-current Assets Held for Sale and Discontinued Operations

BC64 Under AASB 5 paras. 6–8, among other conditions, a non-current asset is classified as held for sale only if the asset is available for immediate sale and its sale must be highly probable. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated.

BC65 For the purposes of paragraph F9, in respect of a non-financial asset not held primarily for its ability to generate net cash inflows, the presumption that the current use of an asset is its highest and best use can be rebutted even if the conditions in AASB 5 are not met. That is, for the presumption to be rebutted, the entity need not have initiated at the measurement date an active programme to:

(a) locate a buyer (or to transfer the asset to another entity); or

(b) complete the plan to use the asset for an alternative purpose.

Waiting until one of those events occurs could deprive users of financial statements of a not-for-profit public sector entity of valuable information about an alternative use having become an asset's highest and best use, as supported by the due diligence underpinning a decision by the entity's appropriate level of management to commit to a plan to take one of those steps. In addition, in contrast with AASB 5, under paragraph F9, it is not essential that the committed-to plan is for the sale of the asset: the plan may be to use the asset for an alternative purpose.

Question for Board members

Q14: Do Board members have any comments on draft paragraphs BC60–BC65 regarding the rebuttable presumption that an asset's current use is its highest and best use, for an asset not held primarily for its ability to generate net cash inflows?

Note 16 to Board members – BC regarding paragraph F11(a)

48. Only editorial changes were made to the draft BC considered by the Board at its November 2021 meeting, regarding the assumed location of an asset, as shown in marked-up text in paragraphs BC66–BC74 below.

Assumed location of an asset when applying the cost approach (paragraph F11(a))

BC66 This issue relates to ~~real property~~ an asset of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows and measured under the cost approach (e.g. a public school or public hospital). This issue mainly concerns the fair value measurement of real property.

BC67 The Board was asked to clarify whether the location of the real property being valued should necessarily be the property's existing location, particularly in view of the principle that an asset's current replacement cost reflects replacement in the most economical manner. For example, if a facility could deliver its services equally well in a nearby location with cheaper land, the Board was asked whether it be assumed that "the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility" (as referred to in AASB 13 para. B9) reflects the price of the facility in the cheaper location.

BC68 Some stakeholders argued that the facility's market value estimate should reflect the price of suitable property in a cheaper feasible location because a market participant buyer would not be willing to pay for an asset at a more expensive location, if the facility could deliver its services equally well in a nearby location with cheaper land. They argued that applying the generally accepted principle that an asset's current replacement cost is measured on an optimised basis by reference to the price of a modern equivalent asset, the modern equivalent asset would be a nearby asset in a cheaper location.

BC69 These stakeholders argued that the market value premium of property in its existing location over a suitable alternative location is a commercial element superfluous to the entity's not-for-profit (service delivery) objectives. They note that their view is consistent with the following text of The Royal Institution of Chartered Surveyors' Guidance Note *Depreciated replacement cost method of valuation for financial reporting* (November 2018):[1]

> "Although the ultimate objective of the DRC method is to produce a valuation of the actual property in its actual location, the initial stage of estimating the gross replacement cost should reflect the cost of a site suitable for a modern equivalent facility. While this may be a site of a similar size and in a similar location to the actual site, if the actual site is clearly one that a prudent buyer would no longer consider appropriate because it would be commercially wasteful or would be an inappropriate use of resources, the modern equivalent site is assumed to have the appropriate characteristics to deliver the required service potential. The fundamental principle is that the hypothetical buyer for a modern equivalent asset would purchase the least expensive site that would realistically be suitable and appropriate for its proposed operations and the envisaged modern equivalent facility. …" (paragraph 7.1)
>
> "… An example could be a hospital that was originally constructed in the centre of a city that might now be better situated in the suburbs because of changes in the transport infrastructure or in the migration of the population it served." (paragraph 7.2)

BC70 In contrast, some other stakeholders argued that the current replacement cost of real property should always reflect the property's existing location, rather than the price of land in a cheaper feasible site. This is because the land's characteristics include its location, and the price premium for the existing site (compared with a cheaper feasible site) could be realised through sale and reinvested in other assets used to provide services. For example, the Application Guidance included in the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17 *Property, Plant and Equipment* states that:

> "If depreciated replacement cost is used to measure the fair value of property, plant and equipment: (a) The value of the land shall reflect the fair value of the land held, in terms of both its size and location; …" (paragraph AG2)
>
> "In instances where land is underutilised, the fair value of the land shall be determined by reference to the highest and best use of such land. For example, in a case where specialised facilities are located in a prime central business district site but the operation would be able to run from a smaller sized and/or less valuable alternative site offering the same service potential, the fair value of the land would be the market value of the entire central business district-located site." (paragraph AG9)

BC71 Similarly, some stakeholders argued that, from the perspective of market participants, the property in a more expensive location provides superior services. For example, an office space in a central business district location provides greater service capacity than office space in an inner suburb by having greater proximity to stakeholders and urban infrastructure and by assisting the entity to attract and retain staff. These stakeholders are also of the view that if the property's service capacity can be relocated to another location, then the highest and best use of the current property is not limited to its existing use; and therefore, should be valued at its current location, reflecting its highest and best use.

BC72 Having regard to these conflicting views, the Board noted that it could theoretically be argued that the current replacement cost of an item of real property of a not-for-profit public sector entity should be measured as follows:

(a) if the real property needs to remain in its existing location due to legal restrictions or operational requirements, the property's current replacement cost should ~~include the market price of land in~~ be based on replacement in the existing location; and

(b) if the real property does not need to remain in its existing location, the property's current replacement cost should be measured in the location that results in the higher of the following measures:

(i) the price a market participant would be prepared to pay to remove the improvements and then sell the property as a vacant site for an alternative use – reflecting the property's existing location. This

[1] This Guidance Note is not explicitly identified as applying to fair value measurements, or non-fair value measurements, using depreciated replacement cost. However, paragraphs 2.1 and 2.2 of the Guidance Note refer to depreciated replacement cost being used in relation to the 'cost approach' to valuation, and to the market and income approaches as the other principal approaches to valuation, implying the Guidance Note would be relevant to fair value measurements (even if not exclusively).

is because an asset's fair value can never be less than the price for which that asset could be sold at the measurement date (excluding transaction costs); and

(ii) the price a market participant would be prepared to pay to replace the service capacity of the land and improvements in their existing use in the most economical manner. This amount would include the market price of land in the cheapest legally permissible location compatible with the entity's operational requirements for the facility. This is because, as an alternative to purchasing the asset subject to measurement, a market participant would build a modern equivalent property in an alternative site, if it would be cheaper than purchasing the asset in its existing location.

BC73 However, on further deliberation, the Board observed that the approach described in paragraph BC72 would have the following disadvantages:

(a) it is inconsistent with the view, which the Board supports, that the current replacement cost of real property should always be measured in its present location because the service capacity of a property being replaced is the sum of:

(i) its capacity to provide services in its existing use; and

(ii) its residual value (the present value of the net cash inflows from sale of the property at the end of the useful life of the improvements on the land), including the subsequent sale of the land component of the property (at its existing location). An asset's residual value contributes to the entity's capacity to provide services (and thus, indirectly, is another component of the existing asset's service capacity);

(b) it is unnecessarily complex. It would generally be very difficult to identify which location, of a potential variety of alternative locations with possibly significantly different market prices of land, might be used as the assumed alternative location; and

(c) it would be time-consuming and costly for preparers and auditors of financial statements. The additional cost of potentially preparing multiple valuations and due diligence assessments would be unlikely to be justified by the benefits to users of the financial statements.

BC74 In light of the concerns in paragraph BC73, the Board concluded that the current replacement cost of an ~~item of real property~~ asset, including real property, of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows ~~would~~ should be measured by assuming the asset is replaced in its existing location, even if it would be feasible to relocate the asset to a cheaper location ~~site~~.

Question for Board members

Q15: Do Board members have any comments on draft paragraphs BC66–BC74 regarding draft paragraph F11(a) relating to the assumed location of an asset when applying the cost approach?

Note 17 to Board members – BC relating to paragraphs F11(b)–F12

49. The draft BC related to the nature of costs included in current replacement cost has been updated to reflect stakeholder comments received on the 16 December 2021 staff paper. Key changes made to the draft BC considered by the Board at its November 2021 meeting are:

(a) added a description of a reference asset, by adapting the concept of a modern equivalent asset and a replica asset referred to in IVS 105 (paragraphs BC77–BC78);

(b) added paragraph BC82 to address stakeholder comment that the proposed requirement in paragraph F11(b) – when applying the cost approach, an entity assumes that the asset presently does not exist – seems counter-intuitive when the asset actually exists;

(c) added more explanation of the treatment of costs of removing and disposing of unwanted existing structures on land (paragraphs BC84–BC91);

(d) added a new section about disruption costs (paragraphs BC92–BC102). This section includes staff's rationale for recommending that, in respect of costs to restore another entity's asset that would be disrupted in the hypothetical construction of the subject asset, only restoration costs associated with an asset of an entity outside the holder's consolidated group should be included in the subject asset's CRC; and

(e) added a new section (in response to stakeholder comment) explaining whether the calibration technique referred to in AASB 13 para. 64 should be applied when an asset's CRC includes costs not yet actually incurred by the entity and therefore results in a higher fair value of the asset compared with the initial capitalisation of cost (paragraphs BC103–BC107); and

(f) added a new section explaining the rationale for the proposed requirement in paragraph F12(c) that, when applying the cost approach, the asset's CRC should be estimated using the costs necessarily incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than using only the cheapest legally permitted costs to the entity (paragraphs BC108–BC109).

Nature of costs included in current replacement cost (paragraphs F11(b)–F12)

BC75 The Board was asked to clarify which costs should be included in the current replacement cost of an asset held by a not-for-profit public sector entity when applying the cost approach under AASB 13 paras. B8–B9, particularly where such an asset is constructed by or on behalf of the entity (i.e. not replaced in a single transaction). Specifically, stakeholders requested the Board to clarify whether the following costs should (among other costs) be included in the current replacement cost of the asset subject to measurement (the subject asset):

(a) once-only costs (i.e. costs of parts of an asset not expected to actually be replaced in the future, because they are not expected to wear out, but that would need to be incurred in a hypothetical acquisition or construction of the subject asset assuming it does not presently exist);

(b) costs of removal and disposal of unwanted existing structures on land; and

(c) intrinsically linked disruption costs, including costs of restoring another entity's asset that would be disrupted in a hypothetical replacement of the subject asset (the nature of disruption costs is explained in paragraph BC92).

BC76 Stakeholders also requested the Board to clarify, when identifying the component costs to include in an asset's current replacement cost, whether it should always be assumed that the asset would be replaced in the most economical manner, even if the entity would, in its ordinary course of operations, be required to incur additional costs.

The overall principle

BC77 The Board noted that, consistent with International Valuation Standard IVS 105 *Valuation Approaches and Methods* (effective 31 January 2022), measuring the fair value of an asset applying the cost approach generally requires an entity to:

(a) estimate the replacement cost of a reference asset as input; and

(b) adjust that estimated replacement cost of a reference asset for any differences between the reference asset's current service capacity and standard of finish, and those of the subject asset.

BC78 IVS 105 mentions that a reference asset could be a modern equivalent asset or a replica asset (where the utility offered by the subject asset could be provided only, or more cheaply, by a replica rather than a modern equivalent asset). Paragraph 70.5 of IVS 105 describes a modern equivalent asset as an asset "… that provides similar function and equivalent utility to the asset being valued, but which is of a current design and constructed or made using current cost-effective materials and techniques."

BC79 In respect of determining which costs should be included in estimating the current replacement cost of the subject asset, two main views have been expressed by stakeholders:

(a) View 1: The current replacement cost of an asset should exclude any components of the asset that will not require replacement in the future because their service capacity does not expire over time (i.e. once-only costs should be excluded). For example, in relation to a road, they argue that an estimate of its current replacement cost should exclude the cost of ~~land,~~ design work, earthworks and formation costs because those components do not wear out or become otherwise obsolete, and therefore do not require replacement in the future; and

(b) View 2: An asset's current replacement cost should be based on the current market buying prices the entity would need to incur at the measurement date to perform the construction work it performed when it constructed the asset (i.e. the nature of the costs included in the asset's current replacement cost should be based on the entity's environment when it constructed the asset rather than the entity's current environment, which affects market participants' pricing assumptions at the measurement date).

BC80 The Board concluded that neither View 1 nor View 2 fully reflects the principles of AASB 13. This is because:

(a) IFRS 13 para. BC30 states that the definition of fair value in IFRS 13 assumes a hypothetical exchange transaction. Therefore, the components of replacement cost included in an asset's fair value are not limited to actual replacement transactions expected to occur in the future; and

(b) AASB 13 paras. B8–B9 state that the cost approach to measuring an asset's fair value reflects the amount that would be required *currently* to replace the asset's service capacity. From the perspective of the market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a reference asset (as described in paragraph BC78) ~~substitute asset of comparable utility~~, adjusted for obsolescence.

BC81 The Board concluded that the current replacement cost of an asset includes all necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date (and not at the asset's historical date of construction). This is because a market participant buyer of the ~~entity's~~ subject asset would need to incur those costs if it acquires the subject asset at the measurement date, whether that buyer acquires the subject asset from the entity or constructs the subject asset itself. Consequently, in estimating the current replacement cost of an asset, an entity estimates all necessary costs intrinsically linked to acquiring or constructing the subject asset assuming it presently does not exist ~~it should be assumed that the asset presently does not exist~~ (i.e. the market participant buyer does not presently possess the subject asset and needs to acquire it in its entirety); therefore, the following costs should be included in an asset's current replacement cost:

(a) once-only costs ~~should be included~~; and

(b) costs of removal and disposal of unwanted existing structures on land (where it would be necessary for a market participant buyer to incur those costs).

BC82 The Board noted a comment made by some stakeholders that it might seems counter-intuitive, when applying the cost approach, to assume (for the purposes of a hypothetical sale) that the asset does not exist, when the asset actually exists. The Board acknowledged that the definition of fair value in AASB 13 para. 9 refers to the price that would be received to *sell* an asset (i.e. exit price). However, when the best evidence of an asset's fair value (maximising the use of relevant observable inputs) is not data about an asset's selling price or net cash inflows from use (and therefore the cost approach is applied), the asset's fair value is derived by regard to the asset's market *buying price* (often the sum of a number of purchase prices for the asset's components). In this regard, the market buying price that a market participant buyer would be prepared to pay for an asset that is the subject of measurement (i.e. the subject asset) is estimated by reflecting the fact that the market participant buyer presently does not possess the subject asset. Often, it would be necessary to use the pricing assumptions of the entity holding the subject asset (e.g. when the asset is specialised) to estimate the pricing assumptions of a market participant buyer; in that context, it is assumed that the entity does not hold the asset (as a proxy for the market participant buyer).

Once-only costs

BC83 Current replacement cost assumes hypothetical replacement or reconstruction of the asset being measured, and is not limited to costs of replacements the entity expects to incur in the future (which is a matter of budgeting rather than measurement of existing resources). To conclude otherwise would imply that the fair value of an asset measured under the cost approach would be zero if, at the measurement date, the holder of the asset expects the asset neither to be replaced at the end of its useful life nor to have components replaced during its remaining useful life. Therefore, the Board reached the view that the current replacement cost of an asset ~~includes necessary~~ does not exclude once-only costs that market participants would expect to necessarily incur when constructing the asset, despite once-only costs not being expected to actually be incurred again in the future by the entity in relation to the subject asset ~~those components not being expected to be replaced by the entity holding the asset~~.

Costs of removal and disposal of unwanted existing structures on land

BC84 Entities would need to apply judgement in the circumstances of the subject asset ~~being measured~~ to determine the necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date, assuming the subject asset presently does not exist~~(in accordance with paragraph F6). As indicated in paragraph F8, an entity applies judgement to determine~~. This would include whether it would be necessary for the market participant to remove and dispose of existing structures on land in order to hypothetically construct the subject asset ~~being measured~~ at the measurement date.

BC85 For example, to measure the current replacement cost of a specialised building, an entity would consider whether a market participant buyer would be able to acquire ~~that building on~~ a vacant site in the area surrounding the existing location. If suitable vacant sites are available ~~(e.g. an adjacent vacant site)~~, market participants would be unlikely to pay for the current cost to demolish existing structures on the site (and, therefore, it would be unlikely that such a cost would be considered 'necessarily incurred'). Similarly, if market participants are able to acquire a suitable parcel of land with an existing structure that they could modify as necessary to create a modern equivalent asset, it would be unnecessary to remove and dispose of existing structures on land in order to hypothetically construct the subject asset.

BC86 Some stakeholders commented that the treatment of costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct the subject asset at the measurement date should be consistent with the treatment of costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located (AASB 116 para. 16 identifies this type of costs as part of the cost of an item of property, plant and equipment). Those stakeholders commented that if there is no present obligation for an entity to incur such removal costs, such costs should not be included in an asset's current replacement cost. Some other stakeholders asked for clarification of the relationship between the two types of costs referred to in this paragraph.

BC87 The costs included in an asset's current replacement cost, as a measure of the amount a market participant buyer would be prepared to pay for the asset, represent the costs avoided as a result of the entity possessing the service capacity embodied in the asset. Consistent with the related comment in AASB 13 para. B9, the market participant buyer is prepared to pay the current amount of those costs avoided, and no more. For example, costs to remove and dispose of unwanted existing structures on land would be included in an asset's current replacement cost if:

(a) a market participant buyer would have no choice but to incur those costs to construct an asset with equivalent service capacity to that of the entity's subject asset (because of a lack of suitable vacant land at the measurement date); and

(b) the subject asset (land or improvements, or both) does not have any of those unwanted structures; and, therefore acquiring the subject asset would save a market participant buyer from incurring those removal costs.

BC88 Where the conditions in paragraphs BC87(a) and (b) are satisfied, the costs to remove and dispose of unwanted existing structures on land would be those of the typical market participant buyer. However, in the absence of reasonably available observable data about the costs saved by the market participant buyer, the entity would use its own assumptions about the removal costs it would incur if, hypothetically, those unwanted structures existed.

BC89 In contrast with costs to remove and dispose of unwanted existing structures on land, the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located are end-of-economic-life costs. The determination of whether those latter costs would merit inclusion in the asset's current replacement cost would involve an assessment of whether the market participant buyer of the subject asset would pay for those costs, which in turn would depend on whether possessing the subject asset would save the market participant buyer from having to incur those end-of-economic-life costs.

BC90 The Board considered that, in general, end-of-economic-life costs are asset-related costs that are unlikely to be avoided by the market participant buyer as a result of acquiring the subject asset. Therefore, it would generally seem logical to exclude those costs from an estimate of the subject asset's current replacement cost.

BC91 However, the Board also considered that the identification of whether the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located would merit inclusion in an asset's current replacement cost would depend on the circumstances, and is a matter for detailed valuation assessments. Therefore, the Board decided not to stipulate whether those costs should be included in an asset's current replacement cost.

Disruption costs, including costs to restore another entity's assets

BC92 The Board was asked to clarify whether the subject asset's current replacement cost should include the cost to restore another entity's asset that would be disrupted during the hypothetical construction of the subject asset (e.g. drainage works of another entity disrupted when replacing a road). The Board decided to develop proposed guidance on such restoration costs and other disruption costs arising upon the hypothetical construction of the subject asset; those costs are collectively termed 'disruption costs' in this [draft] Standard. Examples of disruption costs other than costs of restoring another entity's assets are costs of directing and diverting traffic (including the hire of safety barriers) and costs of employing safety officers.

BC93 The key principle underpinning the inclusion of disruption costs (including, but not limited to, costs to restore another entity's assets that would be disrupted during the hypothetical construction of the subject asset) in the current replacement cost of a subject asset is that, as specified in paragraph F11(b), to reflect the pricing assumptions of market participants, a subject asset's current replacement cost includes all necessary costs intrinsically linked to acquiring or constructing that asset at the measurement date.

BC94 The Board considered the following comments expressed by some stakeholders that it would be inappropriate to include the cost to restore another entity's asset in the current replacement cost of an asset held by the entity:

(a) because the entity does not control the other entity's asset that is being restored, it would be inappropriate to include in the measurement of the subject asset costs relating to the asset that would be restored;

(b) if the entity did not incur those costs when the subject asset was initially constructed, or if those disrupted assets did not exist when the subject asset was initially constructed. This is because including such restoration costs would increase the subject asset's fair value simply because of a change in the asset's operating environment (without the entity having improved the asset's service capacity), which would not faithfully represent the entity's performance; and

(c) if the other entity is within the same consolidated group as the holder of the subject asset, including those costs would result in double counting the restoration costs in the consolidated financial statements for the group. This is because the consolidated financial statements would include both of the following costs used under the cost approach:

(i) the current replacement cost of the disrupted asset of the other entity; and

(ii) the current replacement cost of the subject asset, including the costs to restore the other entity's asset.

BC95 In relation to the concern noted in paragraph BC94(a), the Board regards such restoration costs as costs of obtaining access to the service capacity embodied in the entity's subject asset. The Board noted that such costs restore, rather than enhance, the disrupted asset and, accordingly, are confined to the consequences of acquiring or replacing the entity's subject asset.

BC96 In relation to the concern noted in paragraph BC94(b) about recognition of an increase in an asset's fair value without the entity incurring a related cost (and therefore a gain being recognised), the Board noted that these increases are examples of various increases in the market buying prices of components of assets that continue to be held by the entity and do not involve a related cost to the entity. The Board considered that a market participant would be willing to pay more for an asset due to the change in the asset's operating environment, despite the asset's service capacity to produce outputs not having improved. This is because all costs to restore another entity's asset would necessarily be incurred by a market participant if it were to acquire or construct the subject asset at the measurement date. Those additional restoration costs are necessarily incurred to obtain access to the services the subject asset is expected to generate. Similarly, a market participant would consider the costs currently avoided by possessing the subject asset: these costs are not limited to those already incurred by the entity or to restoration costs that would have been incurred to initially acquire or construct the asset.

BC97 The Board agrees with the concern noted in paragraph BC94(c) that the consolidated financial statements of the group to which the entity belongs would be overstated if both the disrupted asset and the subject asset are measured at their current replacement cost and included in the consolidated financial statements. Therefore, the Board decided that the current replacement cost of the subject asset should exclude any costs that hypothetically would be incurred to restore assets of an entity within the same consolidated group as the holder of the subject asset.

BC98 In reaching that decision noted in paragraph BC97 about the double-counting issue described in paragraph BC94(c), the Board considered whether, instead, it would be appropriate to exclude such restoration costs from current replacement cost on the grounds of simplicity, for all non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. However, the Board decided against this approach because feedback from some stakeholders (in particular, local government) supported including restoration costs for another entity's assets – consistent with local governments not being identified as entities included in a group of entities that prepares consolidated financial statements.

BC99 The Board acknowledged that the proposed exclusion of such restoration costs for assets of entities outside the consolidated group to which the holder of the subject asset belongs would depart from the conceptual principle that an individual entity's assets are accounted for by reflecting the entity's perspective (rather than the perspective of the group). The Board considered that a more conceptual variation of the approach noted in paragraph BC97 would be to provide guidance that such restoration costs are included in an individual entity's financial statements where the entity is part of a group of entities that prepares consolidated financial statements, but eliminated on consolidation. However, in view of the cost involved in tracking such restoration costs at each measurement date, only to omit those restoration costs from the consolidated financial statements for the group, the Board considers that the costs of applying that more conceptual variation would be likely to outweigh the benefits of that approach.

BC100 The Board also considered a concern expressed by some stakeholders that including the cost to restore another entity's asset in the subject asset's current replacement cost implies that the subject asset presently exists, which contradicts the general assumption in paragraph F11(b) that the replacement cost of an asset is calculated by assuming that the asset presently does not exist. The Board disagrees with this view. The Board observed that, when acquiring or constructing an asset in a hypothetical transaction, assets of other entities may be disrupted. The fact that those disrupted assets of other entities might not have existed when the subject asset was actually acquired is irrelevant to the assumptions about a hypothetical current acquisition transaction.

BC101 The Board considered whether to omit the statement in paragraph F11(b) that estimates of the replacement cost of the subject asset assume that the asset presently does not exist, while retaining that paragraph's requirement that all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date are included the subject asset's current replacement cost. However, the Board noted that the assumption in paragraph F11(b) provides the conceptual underpinning for that paragraph's requirement: without it, that requirement would simply be a rule. The assumption links the measurement of current replacement cost to the fair value measurement objective of estimating the amount the market participant buyer would pay for the asset, since the market participant buyer is assumed not to possess any part of the subject asset when bidding for that asset.

BC102 The Board does not propose including in the subject asset's current replacement cost any costs to restore other assets of the entity that would be disrupted in a hypothetical construction of the subject asset. This is because including those costs would double count them in fair value measurements of the entity's assets. If those other assets controlled by the entity are measured under the cost approach, their current replacement cost would include all costs of constructing them (or paying another entity to construct them) in their entirety. Therefore, the sum of the current replacement cost of each of the entity's assets should exclude any restoration costs relating to the entity's own assets.

Whether calibration is needed

BC103 In relation to including in the current replacement cost of a subject asset restoration costs of another entity's assets that were not incurred on initial acquisition of the subject asset (see paragraph BC94(b)), one stakeholder requested the Board to clarify whether including in an asset's current replacement cost any costs not yet actually incurred by the entity (and therefore resulting in a higher fair value of the asset compared with the initial capitalisation of cost) would require the application of the 'calibration' techniques referred to in AASB 13 para. 64. The stakeholder commented that, if calibration were required, the estimate of an asset's current replacement cost would be calibrated in such a manner that the estimate reflects actual transaction prices (i.e. excludes any cost components not yet incurred by the entity, such as those hypothetical costs to restore another entity's assets described above). AASB 13 para. 64 states that:

> "If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset … that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset …) at the measurement date."

BC104 The Board considered the suggestion in paragraph BC103 and decided not to propose requiring estimates of a non-financial asset's current replacement cost to be restricted to actual transactions, as an application of AASB 13 para. 64. This is because:

(a) the Board considers that many inputs to estimates of the current cost of restoring another entity's asset (e.g. current unit costs, including costs of labour and materials) are likely to be observable, whereas AASB 13 para. 64 applies to valuation techniques that use unobservable inputs; and

(b) using costs of restoration work yet to be incurred involves neither of the circumstances specifically mentioned in AASB 13 para. 64, namely:

  (i) calibration being necessary to ensure the fair value estimate reflects current market conditions; and

  (ii) the valuation technique does not capture a characteristic of the asset.

BC105 If AASB 13 para. 64 were to be applied to the situation described in paragraph BC103 – measuring those assets at their actual transaction price, which would be lower than its current replacement cost that includes unavoidable hypothetical costs required in paragraph F12(b) – it would appear to nullify the aim of AASB 116 para. Aus15.1. AASB 116 para. Aus15.1 specifies that not-for-profit entities must initially measure the cost of an item of property, plant and equipment at fair value in accordance with AASB 13 where the consideration for the asset is significantly less than fair value principally to enable the entity to further its objectives. The transaction price would apparently be the amount of consideration paid for the asset, by applying AASB 13 para. 64, fair value at initial recognition would equal the cost of acquisition (rendering AASB 116 para. Aus15.1 redundant).

BC106 In relation to paragraph BC104(b), the Board noted that paras. BC143–BC146 of the IASB's Basis for Conclusions on IFRS 13 indicate that the valuation adjustments involving calibration relate to measurement uncertainty, mainly in respect of financial assets and liabilities. The two circumstances identified in IASB para. BC145 that are not confined to financial assets and liabilities are where:

(a) calibration is necessary to capture a characteristic of the asset or liability; and

(b) measurement uncertainty has arisen from a significant decrease in the volume or level of market activity for the asset or liability.

BC107 The Board considers that neither of the circumstances referred to in paragraph BC106 seems particularly applicable to the treatment of restoration costs yet to be incurred by the entity at the measurement date.

The most economical manner of hypothetical replacement

BC108 Application of the cost approach assumes implicitly a hypothetical acquisition or construction of the subject asset occurs in the most economical manner. However, stakeholders informed the Board that in many cases, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs in order to maintain an adequate quality of services to the public. Where the entity or another market participant replaces an asset, and it would necessarily incur additional costs than the cheapest legally permitted costs, the more expensive costs would be those most likely to be included in the pricing assumptions of the market participant and to be incurred in the ordinary course of operations.

BC109 Therefore, the Board decided to propose that, when determining the costs necessarily incurred in acquiring or constructing the subject asset at the measurement date:

(a) those costs should be based on the context of the entity's mode of replacement in the ordinary course of operations; and

(b) if replacing an asset in the ordinary course of the entity's operation would mean that it would be necessary for the entity to incur costs additional to the cheapest legally permitted costs to the entity, the higher costs should be included in the subject asset's current replacement cost.

Question for Board members

Q16: Do Board members have any comments on draft paragraphs BC75–BC109 regarding draft paragraphs F11(b)–F12 relating to the nature of costs included in current replacement cost?

Note 18 to Board members – Finance costs

50. In relation to borrowing costs and other finance costs, at the Board's November 2021 meeting, staff recommended the Board to consider adding implementation guidance to assist NFP public sector entities to identify who the market participant buyers are for an asset (to determine the borrowing rate to apply), particularly for specialised assets the construction of which is financed by private sector entities. Board members did not agree with those staff recommendations. Their concerns included that:

   (a) in relation to draft paragraph F3 in Agenda Paper 3.2 for the November 2021 meeting, it is unclear what obligation is being imposed on financial statements preparers by the words: "… the entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset"; and

   (b) the treatment of borrowing costs in measurements of the CRC of assets that necessarily take a substantial period to construct should depend on the timing of payments to the constructor (e.g. whether they occur up front, in progress payments as construction occurs or upon completion). Any guidance on borrowing costs should address those differences.

51. As mentioned in Section 3 of Agenda Paper 9.2 for this meeting, staff consider that, if Board members agree with staff's recommended IG on market participant assumptions, as described in draft paragraphs F3–F7, specific guidance on finance costs would be unnecessary.

52. Paragraphs BC110–BC119 have been updated to reflect staff's suggested text to include in the BC section of the ED if draft paragraphs F3–F7 are adopted.

Finance costs

BC110 The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include finance costs, including borrowing costs, in the fair value of an asset that is not held primarily for its ability to generate net cash inflows and is measured at current replacement cost under the cost approach if it necessarily takes a substantial period of time to get ready for its intended use (i.e. whether the current replacement cost of such an asset should include finance costs that would be incurred during a hypothetical construction). In particular, if a private sector entity constructs an asset on behalf of the not-for-profit public sector entity, and if finance costs were to be included in the asset's current replacement cost, some stakeholders asked for guidance on whether the private sector entity's, or public sector entity's, asset-specific borrowing rate should be used in estimating the finance costs.

BC111 ~~The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include borrowing costs in the fair value of a self-constructed asset measured at current replacement cost under the cost approach (e.g. whether the current replacement cost of a self-constructed freeway should include borrowing costs incurred during construction). This issue relates to all self-constructed assets of such entities measured at current replacement cost.~~

BC112 ~~The Board considers that a not-for-profit public sector entity, in deciding whether it should include borrowing costs in the current replacement cost of a self-constructed asset, should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset.~~

BC113 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of ~~a self-constructed~~ an asset is not specific to not-for-profit entities in the public or private sector. It concluded that, in light of AASB 13 not specifying the treatment of those costs for fair value measurements by for-profit entities, it would be inappropriate to mandate a particular treatment for not-for-profit entities applying AASB 13.

BC114 The International Valuation Standards Committee (IVSC) has indicated that consideration should be given to including borrowing costs and equity costs in the fair value of property, plant and equipment. IVS 105 states:

> "The cost elements *may* differ depending on the type of the asset and *should* include the direct and indirect costs that would be required to replace/recreate the asset as of the valuation date. Some common items to consider include: (a) direct costs … (b) indirect costs: … **7. finance costs (eg, interest on debt financing)**, and 8. profit margin/entrepreneurial profit to the creator of the asset (eg, return to investors)." (paragraph 70.11, emphasis added)

BC115 The Board noted that some stakeholders argue that a not-for-profit public sector entity should exclude borrowing costs from the current replacement cost of an asset if that entity elects, under AASB 123 *Borrowing Costs* para. Aus8.1, not to capitalise borrowing costs into the cost of qualifying assets. Some of those stakeholders argued that including borrowing costs in an asset's current replacement cost after writing them off on initial recognition of a qualifying asset would give rise to a revaluation gain that reflects inconsistent treatment of borrowing costs at different measurement dates – which they argue would not faithfully represent a change in the asset's value. The Board notes that this is a similar concern to that noted in paragraph BC94(b) regarding restoration costs included in the current replacement cost of an asset without having been incurred during the asset's initial construction, giving rise to what some stakeholders regard as an anomalous gain.

BC116 The Board considered that the accounting policy choice regarding capitalisation of borrowing costs at the asset's initial recognition under AASB 123 is irrelevant to how those costs should be treated in subsequent measurements of an asset that necessarily takes a substantial period of time to get ready for its intended use. This is because the price that market participant buyers would pay for an asset is unaffected by accounting policies adopted in respect of that asset. The recognition of initial costs and subsequent measurement are fundamentally different processes. Therefore, there should be no presumption that the treatment of borrowing costs should be consistent for both. The Board observed that AASB 13 para. B4 identifies a range of circumstances in which an asset's fair value at initial recognition can differ from its transaction price, indicating that items of comprehensive income can arise from differences between the transaction price reflected in initial measurement and fair value.

Which entity's borrowing rate should be used?

BC117 The Board was also asked to provide guidance to not-for-profit public sector entities about which entity's borrowing rate should be used to measure those borrowing costs, if borrowing costs were to be included in the asset's current replacement cost. ~~The Board considered that the decision about which entity's borrowing rate should be used depends on the identification of the characteristics of the market participant making that pricing decision.~~ The Board considered that, for assets for which the market selling price of an identical or comparable asset is directly observable, the market approach would likely be used to estimate the asset's fair value. Consequently, for such assets, it would be unnecessary to identify which entity's interest rate to use in estimating the asset's fair value because that market selling price would implicitly include any market participant assumptions regarding borrowing and finance costs.

BC118 For assets for which the market selling price of an identical or comparable asset is not directly observable, the cost approach might be used to estimate the asset's fair value. Where the cost approach is used, if borrowing costs or other finance costs are included in the asset's fair value measurement, under the proposed guidance in paragraphs F4–F5:

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

(b) 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, finance costs should be included in the asset's current replacement cost. 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.

BC119 In relation to paragraph BC117, regarding applying the market approach to measure an asset's fair value when the market selling price of a comparable asset is directly observable, the Board noted that paragraph F5(a) 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, the Board considered that any such adjustments would exclude any explicit adjustments for borrowing costs or other finance costs because:

(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.

BC120 ~~Applying the principle in AASB 13 paragraph B9 that "a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset", the amount of any cost (finance or other) that should be included in an asset's current replacement cost is the amount of borrowing costs that market participants save by acquiring the asset from the entity. Therefore, the borrowing rate of market participants should be used.~~

BC121 ~~As mentioned in paragraph F1, if a market participant is not readily identifiable, the market participant buyer for a specialised asset of a not-for-profit public sector entity held primarily for its service capacity is assumed to be another not-for-profit public sector entity with identical or similar purposes for holding the asset, 'stepping into the shoes' of the entity holding the asset. Therefore, for such assets, the market participant is assumed to incur the same borrowing rate as the not-for-profit public sector entity holding the asset for financing the construction of that particular asset, if different from that entity's general borrowing rate (disregarding any discount provided by the Government below the government bond rate if it borrows from the Government).~~

BC122 ~~However, in the case of a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, one further issue remains. That issue is: if the borrowing costs incurred by the Government that controls that entity are not passed on to that entity, should the borrowing rate be assumed to be zero in measuring the current replacement cost of the specialised asset? Answering this question involves identifying the costs that another not-for-profit public sector entity 'stepping into the shoes' of the entity holding the asset would be prepared to pay for when pricing the asset – these may be regarded as the costs avoided by that market participant by acquiring the asset. The Board concluded that the treatment should be consistent with that of any donated resources, whether labour, materials or finance, when applying the cost approach. Therefore, the Board concluded that, if borrowing costs are included in the current replacement cost of a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, the borrowing rate that should be used is:~~

~~(a) the borrowing rate for the asset of the entity holding the asset; or~~

~~(b) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs.~~

BC123 ~~This Standard does not address the issue of whether other finance costs than borrowing costs (such as an imputed cost of equity on a typical equity proportion of financing the construction of an asset) should be included in estimates of an asset's current replacement cost.~~

Question for Board members

Q17: Do Board members have any comments on draft paragraphs BC110–BC119 regarding finance costs?

Note 19 to Board members – BC regarding paragraphs F13–F15

53. As mentioned in Note 10 to Board members, the IG regarding economic obsolescence has been updated to align with the paragraph AG21 of the NZASB's Application Guidance added to PBE IPSAS 17 to remove a probability threshold regarding whether demand for the asset's services will increase (or whether surplus capacity will cease to be considered standby capacity). Accordingly, paragraph BC129 below has been updated to reflect this change.

Economic obsolescence (paragraphs B9 and F13–F15)

BC124 Paragraph B9 states that obsolescence incorporated in an asset's current replacement cost includes 'external (economic) obsolescence'. Paragraph IE12(b) of IFRS 13 gives an example of economic obsolescence of a machine held for use, namely, "conditions external to the condition of the machine such as a decline in the market demand for similar machines".

BC125 An equivalent notion of economic obsolescence of an asset or facility held by a not-for-profit public sector entity is a decline in demand for the services provided by the asset or facility, such as a school. The Board was asked to provide guidance on ~~when to~~ the circumstances in which a not-for-profit public sector entity should identify economic obsolescence of assets measured at fair value using the cost approach, in light of uncertainty and diverse interpretations. In particular, the Board was asked to clarify whether an entity should identify economic obsolescence of a facility that has suffered a reduction in demand for its services before a formal decision has been made to reduce the facility's physical capacity, including a plan for when that decision will be implemented.

BC126 Some stakeholders argued that an entity should not identify economic obsolescence of a facility before a formal decision has been made to reduce the facility's physical capacity because, until then, it is highly unlikely to be clear whether – and to what extent – economic obsolescence exists. The Board noted that the primary consideration in assessing when to identify economic obsolescence is whether market participants would deduct an amount for economic obsolescence from the asset's replacement cost when pricing the asset. This would depend on the entity's circumstances, and not on whether a formal decision has been made to reduce the asset's physical capacity.

BC127 In some instances, it might be clear that market participants would deduct an amount for economic obsolescence when pricing an asset, even if a formal decision has not been made. Deferring inclusion of economic obsolescence in the measurement of the asset's current replacement cost until a formal decision is made would not result in a faithful representation of the adjustment for obsolescence required by paragraph B9. In addition, such deferral would not result in the best estimate of the price that market participant buyers would pay for the asset, and therefore would be inconsistent with the requirement in paragraph 22 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset.

BC128 The Board observed that its conclusion on this issue is consistent with the guidance on the measurement of replacement cost in the IPSASB's Conceptual Framework (paragraph 7.41 of which states that an asset's replacement cost reflects reductions in required service capacity, without mentioning a need to formally decide to reduce the asset's capacity).

BC129 The Board noted that part of the debate about ~~when~~ the circumstances in which to identify economic obsolescence stemmed from perceptions that AASB 13 does not have regard to the temporary or cyclical nature of shortfalls in demand for services rendered by an asset when determining whether economic obsolescence exists. Therefore, the Board decided to clarify that surplus capacity of an asset that is necessary for stand-by or safety purposes should not be identified as economic obsolescence ~~should not be identified for an asset a facility with a current apparent overcapacity 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. Such an illusory overcapacity might be created to cater for expected increases in future demand for the facility's services~~.

BC130 Increases in demand that eliminate an apparent, but illusory, overcapacity need not be long-term in nature. For example, a school in a mining town might presently appear to have overcapacity but require a higher service capacity than indicated by present enrolments, because its enrolments are cyclical due to peaks and troughs in mining activity. Such apparent overcapacity is similar to standby assets held by entities to cope with peaks in demand: such standby assets are not affected by economic obsolescence simply because they are presently inactive. The Board observed that this is consistent with the guidance in:

(a) the IPSASB Conceptual Framework, paragraph 7.41 of which states that the appropriate service potential included in measuring an asset's current replacement cost "is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies"; and

(b) the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17 *Property, Plant and Equipment*. Paragraph AG21 of the Application Guidance included in PBE IPSAS 17[2] states that: "No obsolescence adjustment is made in respect of surplus capacity that, while rarely or never used, is necessary for stand-by or safety purposes."

BC131 The Board was asked to provide guidance on whether, for assets measured at current replacement cost and affected by economic obsolescence (e.g. excess capacity) an entity is required to perform two valuations (one based on the existing capacity, and another based on the estimated needed capacity) in order to estimate the gross replacement cost and related accumulated obsolescence of the asset. The Board concluded that only one valuation, based on the needed capacity (e.g. based on a school for 100 students in the example in paragraph F15), would be required at the measurement date.

Question for Board members

Q18: Do Board members have any comments on draft paragraphs BC124–BC131 regarding paragraphs F13–F15 relating to economic obsolescence?

Note 20 to Board members – BC relating to land

54. After the November 2021 meeting, a stakeholder suggested to staff that, to reduce diversity, it would be beneficial for the Board to consider mandating the use of the market approach in measuring the fair value of land of NFP public sector entities not held primarily for its ability to generate net cash inflows. That stakeholder mentioned there is diversity in some local government entities measuring land at a value that does not appear to have been adjusted for the effect of restrictions imposed on the land.

55. Staff obtained feedback on this suggestion from Panel members at the 1 December 2021 Panel meeting, and also as part of the questions included in the 16 December 2021 staff paper. The majority of stakeholders who commented on this topic supported the Board's tentative decision not to mandate the measurement technique to apply in measuring the fair value of any assets, including land. They disagreed with mandating the market approach (or any other approaches) in measuring the fair value of land.

56. Therefore, consistent with staff's views noted Agenda Paper 3.2 for the November 2021 meeting, staff recommend that no specific fair value guidance is proposed for land. This is because most stakeholders' requests for guidance on fair value measurement pertain to assets that either have limited market inputs, are specialised, or both. Whilst stakeholders commented that the guidance should not be limited explicitly to assets with those features (because of challenges in delineating them), their need for guidance did not (for most stakeholders) extend to land, because most stakeholders who provided feedback to staff consider that the vast majority of land holdings have neither of those features.

57. The rationale for not providing guidance for land is documented in draft paragraphs BC139–BC168, which are largely unchanged from the November 2021 version considered by the Board. The question for Board members on this issue follows the draft explanation in paragraphs BC145–BC168.

58. The main changes to the draft BC for this section considered by the Board at the November 2021 meeting relate to the addition of:

(a) paragraphs BC139–BC144 regarding a specific issue raised by a stakeholder group. This is explained in Note 21 to Board members; and

(b) paragraphs BC145–BC148 to better explain the request for guidance regarding 'public-sector-specific legal restrictions' imposed on land.

[2] That Application Guidance was created by the New Zealand Accounting Standards Board and is additional to the text of IPSAS 17.

Approaches to estimating the fair value of specific public sector assets

BC132 The Board ~~has been requested~~ was asked to ~~consider issuing~~ provide guidance:

(a) on which types of public sector entity assets should be valued under the market, income or cost approach in AASB 13, respectively; and

(b) if the market approach is applied to measure the fair value of ~~restricted~~ assets subject to public-sector-specific restrictions, on the quantum of the discounts deducted from the price of comparable assets that are not subject to those restrictions.

BC133 In relation to the request noted in paragraph BC132(a), the asset types on which stakeholders requested guidance include:

(a) freehold land for which there is an active and liquid market;

(b) land not held in freehold title;

(c) residential or commercial properties located on freehold title;

(d) motor vehicles and other plant for which a primary market exists;

(e) buildings and other man-made structures other than those located on freehold title, where the buildings are of a nature and type similar to those traded in an active and liquid market; and

(f) infrastructure and other man-made assets other than those used primarily to generate profits (including roads, water, sewerage, recreational and park infrastructure assets).

BC134 The Board observed that for various of these types of assets, there does not appear to be a not-for-profit-specific aspect to the issue; therefore, issuing guidance for not-for-profit entities in relation to their application of AASB 13 could result in the guidance being applied by for-profit entities, potentially leading to their inadvertent non-conformity with IFRS.

BC135 AASB 13 para. 61 requires an entity to use valuation techniques that:

(a) are appropriate in the circumstances and for which sufficient data are available to measure fair value; and

(b) maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

BC136 A majority of stakeholders who provided input to the FVM project commented that the ability to apply judgement in the circumstances in choosing among the market approach, income approach and cost approach (or a combination of those approaches) generally works well for measuring the fair value of an asset. The Board considered this comment and formed the view that Australian Accounting Standards should not limit the application of the market approach, income approach or cost approach beyond any limits in the requirements in AASB 13 para. 61.

BC137 Issuing the guidance requested by some stakeholders (i.e. specifying the approach to apply to different types of asset) would appear to conflict with the requirements of AASB 13 para. 61 because it might constrain entities from using the best evidence of fair value in the circumstances. In addition, AASB 13 paras. 62–63 indicate that using a combination of the market, income and cost approaches might be appropriate for various assets. Issuing guidance favouring particular approaches for particular types of assets might be incompatible with that 'combination of approaches' guidance in AASB 13.

BC138 In relation to the request for guidance on the quantum of discounts deducted for the effects of restrictions when measuring the fair value of restricted assets using the market approach (see paragraph BC132(b)), the Board noted that, for land held by not-for-profit public sector entities, the market approach is primarily applied. The Board rejected the notion of developing guidance on the quantum of discounts in relation to land for the reasons set out in paragraphs BC167–BC168.

Note 21 to Board members – Highest and best use of land and improvements on land

59. At its September 2021 meeting, the Board noted that a comment letter on ITC 45 from the South Australian Local Government Financial Management Group (SALGFMG) expressed concerns that some buildings held by local governments are being measured at a fair value of nil because it has been concluded that those buildings would need to be demolished to achieve a higher and better use of the site than its existing use (pages 8–9 of Agenda Paper 13.2 for the September 2021 meeting).

60. Staff note that the IASB has considered this issue when developing IFRS 13. After considering the cost required to prepare separate valuations (if land and improvements on land were to be measured separately), the IASB decided to, consistent with the general principle applying

to fair value measurements of non-financial assets, require an entity to measure the group of assets at fair value based on their highest and best use (which may mean that the fair value of buildings in the SALGFMG example would be measured at nil), but include a disclosure note explaining why the asset is being used in a manner that differs from its highest and best use, in accordance with AASB 13 para. 93(i).

61. Staff explained this in draft paragraphs BC139–BC144 below, which are new and therefore are shaded rather than marked up.

When the current use of land and improvements on land is not their highest and best use

BC139 A group of stakeholders asked the Board to clarify whether the fair value of improvements on land should be measured at nil if it has been concluded that the highest and best use of the land used jointly with improvements is different from its current use and the highest and best use assumes the existing improvements on the land would be demolished. The Board noted that the IASB considered this issue when developing IFRS 13(see paragraphs BC140–BC141), and that this issue is not specific to not-for-profit entities. Therefore, the Board decided not to develop implementation guidance on this issue.

BC140 Paras. BC72–BC73 of the IASB's Basis for Conclusions for IFRS 13 uses an example of a factory. Para. BC72 states that "The IASB concluded when developing the exposure draft" [of IFRS 13] "that measuring the factory at nil would not provide useful information when an entity is using that factory in its operations. In particular, users would want to see depreciation on that factory so that they could assess the economic resources consumed in generating cash flows from its operation." Prior to finalising IFRS 13, the IASB had exposed a proposed requirement for an entity to separate the fair value of the asset group into its current use and fair value components.

BC141 However, after considering responses from its stakeholders that preparing separate valuations for each asset in the group of assets would be costly, the IASB noted in para. BC73 that "… when an entity uses a non-financial asset in a way that differs from its highest and best use (and that asset is measured at fair value), the entity must simply disclose that fact and why the asset is being used in a manner that differs from its highest and best use." That disclosure requirement is stated in IFRS 13 para. 93(i).

BC142 Therefore, when the highest and best use of land and improvements collectively within a group of assets is different from their current use by the entity (i.e. when there is evidence that the current use of the assets is not their highest and best use, and an alternative use would maximise their value), the entity measures the asset's fair value based on its highest and best use (which may mean that the factory in the IASB's example would be measured at nil), but includes a disclosure note explaining why the asset is being used in a manner that differs from its highest and best use, in accordance with AASB 13 para. 93(i).

BC143 The Board noted that AASB 13 para. 31(a)(iii) states that: "assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used." In relation to the question from the group of stakeholders noted in paragraph BC139, the Board noted a view that, consistent with AASB 13 para. 31(a)(iii), it would be inappropriate for land and its improvements to have two different highest and best use assumptions if they are used in combination to maximise value to market participants.

BC144 The Board also noted that para. 17 of AASB 101 *Presentation of Financial Statements* states that to achieve a fair presentation of financial statements, an entity is required to "… provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance". The Board noted a view that, if an entity considers the current value of those improvements based on their current use and periodic depreciation are important to users of financial statements, it would consider whether it should disclose this information to comply with AASB 101 para. 17.

Question for Board members

Q19(a): Do Board members agree with including BC paragraphs to address the issue raised by SALGFMG noted in paragraph 59?

Q19(b): If so, do Board members have any comments on the drafting of paragraphs BC139–BC144?

Fair value measurement of land and improvements on land subject to public-sector-specific restrictions

Original request from stakeholders in 2017

BC145 All land is subject to zoning restrictions, and some land may have an easement restriction. Stakeholders have informed the Board that many not-for-profit public sector entities are subject to other legal restrictions beyond the zoning and easement restrictions (such as legislation specific to the public sector entity or directions from Ministers) prohibiting the entity from using the land and improvements on land for a purpose other than its existing use. For example, a not-for-profit public sector entity might be subject to a legal restriction prohibiting it from using a hospital and the hospital land for a purpose other than as a hospital.

BC146 For ease of reference in this Basis for Conclusions, these other forms of legal restrictions are referred to as 'public-sector-specific legal restrictions'.

BC147 The Board noted that in many cases, the current zoning of the land would reflect land's public-sector-specific legal restrictions, such as having a community zoning that restricts a parcel of land to be used for community purposes. However, there might be situations in which land is zoned for a commercial purpose, but the not-for-profit public sector entity holding the land is subject to legislation preventing that entity from using any of its non-financial assets for a commercial purpose.

BC148 Panel members and other stakeholders who responded to ITC 34 originally asked the Board to provide guidance on:

(a) how public-sector-specific legal restrictions should be treated when measuring the fair value of land and improvements on land that are not held primarily for their ability to generate net cash inflows; and

(b) which measurement techniques should be used in measuring the fair value of such land.

BC149 Stakeholders informed the Board that the fair value of some land subject to public-sector-specific legal restrictions and not held primarily for its ~~service capacity~~ ability to generate net cash inflows has been valued at a very low amount; sometimes a nominal amount (e.g. $1 for some restricted land). They questioned whether measuring such restricted land at such a low value appropriately reflects the service potential of the restricted land. This question was asked in the context of para. Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements* (applicable to not-for-profit entities), which states that 'future economic benefits' or 'service potential' can be described as 'the scarce capacity to provide benefits to the entity that use them'.

BC150 The Board did not form a view on whether measuring such restricted land at a low amount or nominal amount would reflect the capacity of the restricted land available to provide benefits to the holder of the land (or to provide services to the community). The Board is undertaking a project to adapt its *Conceptual Framework for Financial Reporting* (Revised Conceptual Framework) for application by not-for-profit entities, including those in the public sector ~~entities~~. The Board plans to consider the description of service potential in the context of an asset of a not-for-profit entity as part of that project. At this stage it is unclear whether that Board consideration would have implications for the measurement of restricted land.

Legal restrictions specific to an asset versus public-sector-specific legal restrictions

BC151 Consistent with the reasons noted in paragraph BC38 and BC53–BC55, the Board noted that ~~the~~ fair value measurement of an asset ~~of land would~~:

(c) would not take into account a legal restriction that is specific to the entity holding the asset, that is, it would not transfer to a market participant in a hypothetical sale transaction (e.g. the restriction on the use of land that is specific to the entity, in the IASB's example in paragraph IE29 of the Illustrative Examples accompanying IFRS 13 quoted in paragraph BC37); but

(d) would take into account the effect of restrictions that would transfer to a market participant in a hypothetical sale transaction (e.g. the easement restriction in the IASB's example) regardless of whether in that example the land's highest and best use is as a playground or as a site for residential development, because such legal restrictions are considered characteristics of land that a market participant would consider when pricing the land.

BC152 Accordingly, if public-sector-specific legal restrictions imposed on land and improvements on land would not be transferred to market participants, the fair value measurement of those assets would not take into account those legal restrictions. ~~The Board noted that, in some cases, legal restrictions imposed on a not-for-profit public sector entity limiting the use of an improvement (e.g. a building) on a parcel of restricted land, or the prices that can be charged for using that improvement, are entity-specific restrictions that would not be~~

~~transferred to market participants. In this case, the fair value measurement of those improvements would not take into account that pricing restriction that would not transfer to market participants~~.

BC153 As noted in paragraph BC48, IVS 104 para. 140.5(b) states that the determination of an asset's highest and best use involves consideration of the likelihood that any legal restrictions on the use of the asset (e.g. town planning/zoning designations) will change. The Board is of the view that, in the context of identifying the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the likelihood that any public-sector-specific legal restrictions imposed on land and improvements on land will change should be considered in the context of the current social-political environment.

Feedback from public sector stakeholders during outreach

BC154 After conducting wide-ranging outreach, including outreach on ITC 45, the Board noted feedback that there is not significant diversity in how the fair value of restricted land and improvements on restricted land not held primarily for their ~~service capacity~~ ability to generate net cash inflows are being measured. In this regard:

(a) most stakeholders commented that the market approach is used to measure the fair value of land, including ~~restricted~~ land subject to public-sector-specific legal restrictions; whereas improvements on such restricted land are generally considered specialised assets, for which the cost approach is generally applied in measuring their fair value; but

(b) a minority of stakeholders commented that, when a parcel of land of a not-for-profit public sector entity not held primarily for its ~~service capacity~~ ability to generate net cash inflows is subject to public-sector-specific legal restrictions, but an equivalent ~~restricted~~ parcel of land with the same public-sector-specific legal restrictions is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the fair value of such land should be measured using the cost approach.

BC155 The views of these stakeholder groups are elaborated on in paragraphs BC156–BC167.

The minority view regarding ~~restricted~~ land subject to public-sector-specific legal restrictions

BC156 The minority of stakeholders mentioned in paragraph BC154(b) considered that the cost approach would be the most appropriate measurement technique for measuring the fair value of restricted land where an equivalent parcel of ~~restricted~~ land subject to the same public-sector-specific legal restrictions is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. They also commented that if the cost approach is applied, those public-sector-specific legal restrictions would not reduce the fair value of such restricted land ~~would not be lower~~ to an amount less than the price of equivalent land without those restrictions ~~unrestricted land because of the effect of the~~. This is because, if an equivalent restricted parcel of land is not obtainable in the marketplace, the entity would need to purchase an equivalent ~~unrestricted~~ parcel of land without those restrictions to continue delivering services, and the existence of such a restriction does not affect the price of this purchase.

BC157 ~~'Equivalent unrestricted land' referred to in paragraph BC156 might be restricted in use by zoning other than for a public-sector-specific purpose (e.g. it might be zoned for residential, commercial or light industrial use) or by an easement providing access to other services.~~

BC158 Those stakeholders reached this view because they interpreted that, when applying the IASB's views in IFRS 13 paras. BC78–BC79:

(a) many parcels of ~~specialised~~ land might have little value if sold (due to the restrictions), but would have a significant value to the holder of the asset (in terms of the asset's ability to provide goods or services to beneficiaries) when used together with other non-financial assets; and

(b) the ~~cost or income~~ market approach might be ~~more appropriate~~ inappropriate in measuring the land's fair value when the market price of the land represents the use of the land on a stand-alone basis rather than in combination with complementary assets.

BC159 Further, those stakeholders considered that, because the ~~restricted~~ land subject to public-sector-specific legal restrictions is not held primarily for its ~~service capacity~~ ability to generate net cash inflows, it would generally be inappropriate to apply the income approach as an alternative to the market approach and, consequently, the cost approach should be used to measure the fair value of such restricted land.

The majority view regarding restricted land

BC160 The majority of stakeholders mentioned in paragraph BC154(a) expressed the view that land, including ~~restricted~~ land subject to public-sector-specific legal restrictions, should generally be measured using the market approach. They disagree with the view expressed by the minority of stakeholders noted in BC156 – that the cost approach should be applied in measuring such restricted land, and the fair value of such restricted land would not be lower than the price of equivalent ~~unrestricted~~ land without such restrictions because of the effect of ~~the~~ public-sector-specific legal restrictions, if an equivalent restricted parcel of land is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. Under the market approach, the fair value of a parcel of land should reflect any restrictions on that land, including any public-sector-specific legal restrictions, that would transfer to market participants in a hypothetical sale transaction.

BC161 This majority of stakeholders commented that although an 'equivalent' parcel of land with the same public-sector-specific legal restrictions might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence (because public-sector-specific legal restrictions often prevent an entity from selling the land), there are market transactions for other parcels of land that are suitable reference assets. Therefore, those stakeholders consider there are more relevant observable inputs for applying the market approach, rather than the cost approach, in measuring the fair value of land subject to such restrictions.

BC162 ~~These stakeholders~~ Some of the stakeholders referred to in paragraph BC161 also commented that~~, if a parcel of land has improvements on it~~ any improvements (e.g. a hospital building) on a parcel of land ~~the improvements~~ reduce the land's service potential. They consider that improvements on land would reduce the options the not-for-profit public sector entity holder of the land has to use the land for another purpose, unless the improvements are demolished.

The Board's decision to not provide authoritative implementation guidance

BC163 Notwithstanding the interpretation of IFRS 13 paras. BC78–BC79 by a minority of stakeholders, in which they concluded that the cost approach would often be appropriate in measuring the fair value of ~~restricted~~ land subject to public-sector-specific legal restrictions, the Board noted that AASB 13 paragraph 61 requires an entity to select measurement techniques:

(a) that are appropriate in the circumstances;

(b) for which sufficient data are available to measure fair value; and

(c) that maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

BC164 Therefore, the Board considered that determining appropriate measurement techniques for measuring the fair value of an asset is best regarded as ~~belonging within the province of valuation professionals~~ relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards. Unless there is significant diversity in applying accounting principles in practice, there is no clear case for mandating the use of a particular valuation technique in measuring the fair value of a particular type or class of assets.

BC165 Despite the debate regarding fair value measurement of ~~restricted~~ land subject to public-sector-specific legal restrictions, feedback from most stakeholders in targeted outreach and most feedback on ITC 45 indicated that, in practice, the fair value of each type or class of assets affected by this issue is being measured using a largely consistent approach – that is:

(a) for ~~restricted~~ land subject to public-sector-specific legal restrictions, the market approach is used (although, as noted in paragraph BC167 below, at a more detailed level, different methods are being used to calculate the adjustments to reflect restrictions); and

(b) for improvements on such restricted land, the cost approach is generally used, and an adjustment is not deducted to reflect the effect of public-sector-specific legal restrictions because:

(i) those restrictions would not be transferred to market participants; and

(ii) the existence of a public-sector-specific legal restriction does not affect the price that the entity would need to incur to replace the asset at the measurement date.

BC166 In regard to the stakeholders' comment in paragraph BC153, the Board noted that AASB 13 paragraph 11 states that a fair value measurement is for a particular asset; and, therefore, when measuring the fair value of an asset, the entity considers the characteristics of the asset if market participants would take those characteristics into account when pricing the asset at the measurement date, including the condition and location of the asset, as well as any restrictions on the sale or use of the asset. This would include consideration of any public-sector-specific legal restriction that would be transferred to a market participant.

BC167 Some stakeholders commented that there is diversity in practice regarding the amounts (e.g. percentages) of adjustments being deducted from the value of land to reflect public-sector-specific legal restrictions, ~~market price of nearby unrestricted land~~ and asked the Board to provide guidance to reduce that diversity. Further, some stakeholders informed the Board that different valuers use different methods in calculating the adjustments ~~to be deducted from the market price of nearby unrestricted land that is, or may be, used as a reference asset~~, for example:

(a) using the price of nearby ~~unrestricted~~ land not subject to the same public-sector-specific legal restriction and explicitly deducting an adjustment for the effect of the restriction (explicit adjustment); or

(b) using the price of land with a much lower intensity of use – and, consequently, a much lower value – than that of nearby ~~unrestricted~~ land without a public-sector-specific legal restriction and not explicitly deducting an adjustment for the effect of the restriction because it is implicitly taken into account by using cheaper land in a lower-intensity-of-use location as a reference asset (implicit adjustment).

BC168 Since the condition and location of every parcel of land are likely to differ, and the effect of public-sector-specific legal restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted ~~(where that likelihood is more than remote)~~ and whether the land is urban, suburban or rural, the Board considered that it would neither be practical nor appropriate for Australian Accounting Standards to specify the amount of appropriate adjustments (e.g. in percentage terms) under the market approach to reflect the effect of restrictions that would transfer to market participants.

Question for Board members

Q20: Do Board members have any comments on draft paragraphs BC132–BC168 regarding the rationale for not providing guidance on the fair value measurement of land and on specific asset types (excluding the comments on paragraphs BC139–BC144 relating to the issue raised by SALGFMG noted in paragraph 59)?

Note 22 to Board members – Other measurement issues

62. Agenda Paper 3.3 for the Board's November 2021 meeting included analysis of other measurement issues regarding non-financial assets that two members of the Panel asked the Board to address as part of the FVM project.

63. While that paper was not discussed in detail at that meeting, Board members indicated support for the staff recommendations that:

(a) no standard-setting actions are required under the *AASB Not-for-Profit Entity Standard-Setting Framework* and the *AASB Due Process Framework for Setting Standards* to address any of those issues raised; and

(b) the BC section of the forthcoming ED should reiterate existing accounting requirements related to the following issues:

(i) distinguishing obsolescence from depreciation;

(ii) defaulting to the straight-line method of depreciation; and

(iii) the description of accumulated obsolescence.

64. Agenda Paper 3.3 for the November 2021 meeting included draft BC paragraphs related to those issues noted in paragraph 63(b). Changes made to the draft BC considered by the Board at its November 2021 meeting are shown in marked-up text in paragraphs BC169–BC177 below.

Other measurement issues

BC169 Some stakeholders asked the Board to provide guidance regarding the following:

(a) distinguishing obsolescence from depreciation;

(b) method of depreciation;

(c) description of accumulated obsolescence;

(d) treatment of changes in an asset's estimated remaining service potential;

(e) adjusting for additional functionality in the modern equivalent asset, under the cost approach;

(f) treatment of damage of an asset;

(g) allocating the fair value of groups of assets measured under the income approach to component assets;

(h) treatment of deferred maintenance expenditure;

(i) unit of account for an infrastructure asset; and

(j) curable and incurable obsolescence.

BC170 The Board noted that none of the issues in BC169(a)–(j) is a justifiable circumstance under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require not-for-profit-specific modifications or guidance. This is because:

(a) those issues are not specific to not-for-profit entities and the IASB did not provide any further guidance on those issues; and

(b) there does not appear to be any gap or other flaw in existing pronouncements that would cause financial statements of not-for-profit public sector entities to inadequately reflect the objectives and qualitative characteristics of financial reporting or not reflect economic reality.

BC171 The Board considered that some of those issues relate to detailed valuation assessments, and specific guidance on them should not be included in Australian Accounting Standards. The Board also considered that the treatment of many of the issues would depend on facts and circumstances, and the role of principles-based Standards does not include providing detailed guidance about the various outcomes that can arise.

BC172 In addition, the Board noted that existing AASB pronouncements include guidance addressing some issues listed in BC169(a)–(j). These items of guidance are noted in paragraphs BC173–BC177.

Distinguishing obsolescence from depreciation

BC173 Some stakeholders asked the Board to clarify in Australian Accounting Standards that obsolescence for fair value measurement is different from depreciation. Since AASB 13 para. B9 specifies that obsolescence for fair value measurement under the cost approach is different from depreciation under AASB 116, the Board decided that additional guidance is not warranted. AASB 13 para. B9 states that: "Obsolescence … is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives)."

BC174 The Board observed that aspects in addition to the depreciation of an asset need to be considered in measuring the fair value of an asset. AASB 13 para. 11 specifies that fair value measurements take into account characteristics of an asset that market participants would take into account, including, for example, the condition and location of the asset, and any restrictions on the sale or use of the asset.

Method of depreciation

BC175 Regarding comments by some stakeholders that many entities are applying the straight-line depreciation method by default, the Board considers that AASB 116 addresses this issue adequately. AASB 116 para. 60 states that: "The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."

BC176 In addition, the Board observed that Example 3 in the Implementation Guidance (January 2012) accompanying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* illustrates how the change in carrying value and depreciation of a property, plant and equipment (and its related deferred tax) are calculated.

Description used in disclosures of accumulated obsolescence

BC177 In relation to the requirement in AASB 116 para. 73(d) to disclose accumulated depreciation for each class of property, plant and equipment, some stakeholders asked whether another description than 'accumulated depreciation' is permitted for disclosing the amount of accumulated obsolescence in financial statements. In accordance with the principle in para. 57(b) of AASB 101 Presentation *of Financial Statements* that the use of other terms, line items or subtotals in financial statements is permitted where such presentation is relevant to the understanding of the entity's financial position or financial performance, the Board considered that using a term other than 'accumulated depreciation' to describe accumulated obsolescence would not be a breach of AASB 116.

Question for Board members

Q21: Do Board members have any comments on draft paragraphs BC169–BC177 regarding the other measurement issues?

Note 23 to Board members – Prospective application and mandatory application date

65. When IFRS 13 was initially issued, the IASB required prospective application of the Standard, not retrospective application. This is because the IASB was of the view that any change in the methods used to measure fair value when IFRS 13 is adopted is akin to a change in accounting

estimates, which is accounted for prospectively under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

66. Similarly, staff consider that the proposed IG set out in the draft Appendix F clarifies the requirements of AASB 13, rather than changing the requirements, and any changes in the methods used to measure fair value should be treated as a change in accounting estimates. Therefore, staff recommend that the ED proposes prospective application of the authoritative IG. Staff's reasons for suggesting prospective application of the proposals are set out in draft paragraphs BC178–BC181 below.

67. If Board members agree with prospective application of the proposals, staff consider that proposing a mandatory application date one year after the Board issues the final amending Standard would be appropriate, rather than the typical two years as noted in paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards*.

68. That is, assuming the final amending Standard will be issued by end of year 2022, staff are recommending that the amending Standard to applied for annual periods beginning on or after 1 January 2024 (with earlier application permitted), which would be for the financial year ending 30 June 2025 for NFP public sector entities with financial years beginning on 1 July. This is because:

    (a) NFP public sector stakeholders commented that fair value guidance is needed urgently;

    (b) as mentioned in paragraph 66, the proposed IG set out in draft Appendix F clarifies the requirements of AASB 13, rather than changing the requirements; therefore, significant changes to current valuation practice are not expected; and

    (c) setting the effective date of a Standard two years after the Standard's issue date seems to be the typical practice for a Standard that requires retrospective application, rather than prospective application.

69. Staff considered whether a proposed effective date of periods beginning on or after 1 January 2023 (with earlier application permitted) might be appropriate. Staff note that some entities may require more time to understand the proposed guidance and to communicate any changes required to current valuation practice with valuers and auditors.

Effective Date and Transition

BC178 In accordance with paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards*, the Board decided to propose that the modifications to AASB 13 stemming from this proposed Standard should be applied prospectively from annual periods beginning on or after 1 January 2024.

BC179 The Board considers that the Implementation Guidance set out in Appendix F to AASB 13 clarifies the requirements of the Standard, rather than changing the requirements. In accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, prospective application of a new accounting policy does not involve restatement of comparative amounts disclosed in respect of any prior period presented.

BC180 The Board noted that the existing Standard was initially required to be applied prospectively, consistent with IFRS 13 *Fair Value Measurement*. As stated in paragraph BC229 of its Basis for Conclusions on IFRS 13, "… the IASB concluded that a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement) ... Therefore, the IASB concluded that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate)."

BC181 The Board noted that initial application of the Implementation Guidance set out in Appendix F might entail changes in accounting policies by particular not-for-profit public sector entities, including, for example:

(a) the costs to include in the current replacement cost of a non-financial asset; and

(b) changing the assumed location of an asset from that assumed in prior period estimates of current replacement cost.

Questions for Board members

Q22: Do Board members agree with the staff recommendation that the ED should propose prospective application of the authoritative IG?

Q23: If Board members agree with the staff recommendation in Q22, do you agree that the ED should propose a mandatory application date of annual reporting periods beginning on or after 1 January 2024, with earlier application permitted?

Q24: If Board members disagree with the staff recommendation in Q22 (i.e. Board members prefer retrospective application of the proposals), which mandatory application date would Board members prefer to propose in the ED?

Q25: Do Board members have any comments on draft paragraphs AusC7–AusC8 (on page 10) and BC178–BC181?

Comparison with IFRS 13

BC182 Not-for-profit public sector entities complying with this Standard might not comply with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).

BC183 This Standard makes the following modifications to IFRS 13 (which are intended to elaborate its requirements) in respect of certain non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows:

(a) the asset's current use is assumed to be its highest and best use, unless, at the measurement date, the appropriate level of the entity's management has committed to a plan to locate a buyer of the asset (or transfer the asset to another entity) or to use the asset for an alternative purpose (paragraphs F9–F10); and

(b) if measured using the cost approach, to:

(i) assume that the asset will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper location at the measurement date (paragraph F11(a));

(ii) assume that the asset presently does not exist and all components of the asset need to be replaced based on its existing service capacity at the measurement date (paragraph F11(b) and F12(a));

(iii) include the costs necessarily incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than those necessarily incurred only using the cheapest legally permitted costs to the entity (paragraph F12(c));

(iv) not require, for the identification of 'external (i.e. economic) obsolescence', that a formal decision has been made to reduce the physical capacity of an asset (paragraph F13); and

(v) not identify economic obsolescence for the asset if the asset contains surplus capacity necessary for stand-by or safety purposes (paragraph F14).

BC184 In addition, this Standard provides guidance for not-for-profit public sector entities in applying the 'market participant assumptions' and 'financially feasible use' concepts (paragraphs F3–F8).

BC185 IFRS 13 does not specify:

(a) that the entity's own data must be used as a starting point under certain circumstances. AASB 13 paragraph 89 states that the entity's own data *may* be used as a starting point when developing unobservable inputs; and

(b) how the cost approach should be applied, beyond the brief requirements in paragraphs B8–B9.

The requirements of this Standard noted in paragraphs BC183 and BC184 might not comply with IFRS 13.

Question for Board members

Q26: Do Board members have any comments on draft paragraphs BC182–BC185 regarding the statement that application of the draft authoritative IG might not comply with IFRS 13?