



AASB

**AASB ITC 45
Virtual roundtable**

6 July 2021

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1



Agenda

- Overview of proposals in IPSASB ED 76 and ED 77
- Background to AASB ITC 45
- Fair value vs current operational value (COV)
- Polling questions and Q&A on:
 - Key aspects of COV
 - Application of cost approach to fair value and COV
- Next steps & wrap-up

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2

Information about you

Question 1

Please indicate which stakeholder group best describes you.

Are you:

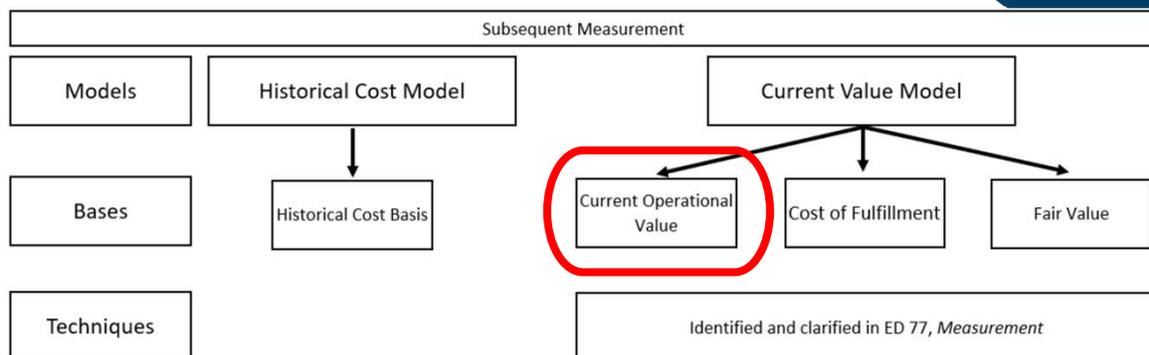
- (a) a valuer; or
- (b) a preparer of financial statements; or
- (c) an auditor; or
- (d) a user of financial statements; or
- (e) other?



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3

Overview of IPSASB's Proposals



Extracted from ED 76 para. 7.6 Diagram 1: The measurement hierarchy for subsequent measurement and the relationship between the three levels



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4

Background to ITC 45

- IPSASB proposes that fair value is inappropriate for assets primarily held for their **operational capacity** and proposes a new measurement basis – **current operational value (COV)**
- Presently, Australian public sector entities measure the current value of **all** non-financial assets at **fair value** under AASB 13 *Fair Value Measurement*
- AASB's **Fair Value Measurement for Not-for-Profit Entities** project (FVM project) → to provide guidance to assist application of AASB 13 in the NFP public sector → particularly on operational assets
- Feedback on AASB ITC 45 would provide useful information to the AASB for its own FVM project



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5

Subject matter for discussion

“Assets held primarily for their **operational capacity**” (“**operational assets**”) or “assets primarily held for their service potential”

- Operational capacity = “the capacity of the entity to support the provision of services in future periods through physical and other resources”
- Essentially same as phrase in AASB 136 *Impairment of Assets* “assets not held primarily for their ability to generate net cash inflows”

Operational assets being **measured at current value** (eg property, plant and equipment measured under the revaluation model in AASB 116 *Property, Plant and Equipment*)

Not discussing operational assets measured under historical cost basis



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6

Fair value vs Current operational value



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7

Definitions

- **Fair value** – The **price that would be received to sell** an asset or paid to transfer a liability in an orderly transaction between **market participants** at the measurement date
- **Current operational value** – The value of an asset used to **achieve the entity's service delivery objectives** at the measurement date
- **Alternative definition of COV** – the **cost to replace the service potential** embodied in an asset at the measurement date



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8

Measurement techniques

- Same measurement techniques can be applied to estimate fair value and COV
- Maximise use of relevant observable inputs and minimize use of unobservable inputs

Market approach	Uses prices and other relevant information generated by market transactions involving identical or comparable assets
Cost approach	Reflects the amount that would be required currently to replace the service capacity of an asset (i.e., current replacement cost)
Income approach	Converts future amounts (e.g., cash flows or revenue and expenses) to a single current discounted amount



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9

Measurement perspective

Fair value	COV
Market participant	Entity-specific
Asset's highest and best use → The use of an asset by market participants that would maximise the value of the asset (or the group of assets within which the asset would be used)	Asset's current use → disregards potential alternative uses → disregards other characteristics of the asset that could maximise its value
Exit value	Entry value

Entry price = exit price when they relate to the same asset on the same date in the same form in the same market (IFRS 13 para. BC44)



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10

Key aspects of current operational value



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11

Should current value measurement reflect the asset's current use only?

Example

Unrestricted vacant land with harbour views is being used as a storage site, with potential to be redeveloped for residential dwellings.

Question 2 (AASB SMC 7)

Should the COV of the unrestricted vacant land be measured as:

- (a) the market price of land that could only be used for storage; or
- (b) the market price of land capable of residential development?



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12

Definition of COV – which would you prefer?

IPSASB's proposal	Alternative view
The value of an asset used to achieve the entity's service delivery objectives at the measurement date	The cost to replace the service potential embodied in an asset at the measurement date

The Alternative view – the definition should focus on the cost to replace an asset because:

- The proposed definition does not clearly state **how** it would **reflect** the **service potential** of an operational asset
- An operational asset's service potential is best represented by the cost the entity is currently required to incur in the marketplace at the measurement date to replace the asset → that information is useful for **decision making** and **accountability** when assets are held for their operational capacity

Service potential → the capacity to provide services that contribute to achieving the entity's objectives



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13

Definition of COV – which would you prefer?

Question 3 (AASB SMC 5)

Do you agree with the definition of current operational value:

- proposed by the IPSASB: “the value of an asset used to achieve the entity's service delivery objectives at the measurement date”; or
- the alternative definition proposed in the Alternative View: “the cost to replace the service potential embodied in an asset at the measurement date”; or
- do you propose another definition?



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14

Should the income approach be permitted to measure assets not held primarily to generate net cash inflows?

The income approach: A measurement technique that converts future amounts (e.g., cash flows or revenue and expenses) to a single current discounted amount.

IPSASB's proposal	Alternative view
<p>Sometimes appropriate under the following circumstances:</p> <ul style="list-style-type: none"> the present value technique (an application of the income approach) is used to support the market or cost approach to discount future <u>outflows</u> to a current amount information is unavailable to apply the market or cost approach 	<p>Should not be permitted under any circumstances because:</p> <ul style="list-style-type: none"> Operational assets are held and used primarily for their service potential rather than to generate net cash inflows Valuation based on the income approach might result in an amount not reflecting the remaining service potential embodied in the asset



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15

Should the income approach be permitted to measure assets not held primarily to generate net cash inflows?

Question 4 (AASB SMC 6)

Do you agree with:

- the IPSASB's proposal that it might sometimes be appropriate to apply the income approach; or
- the Alternative View that it should not be permitted under any circumstances?



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16

Current value of restricted operational assets

Example

The current value of a public school is to be measured, and both the land and buildings are legally restricted for use as a public school.

Current value measurement

If a legally restricted asset (e.g., school) can be replaced by an equivalent restricted asset obtainable in the marketplace for a price supported by observable market evidence → the asset's current value should be based on the **current price of the equivalent restricted asset** (i.e., using the market approach).

The issue is: what if an equivalent restricted asset is **not obtainable**?



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17

Current value of restricted operational assets

An “**equivalent restricted asset**” is an asset:

- subject to the **same restriction(s)** on use or pricing as the asset being measured; and
- capable of providing the **same services** as the services that the asset being measured provides in its existing use.

Consider: if an equivalent restricted asset is not obtainable in the marketplace → should the **price of an equivalent unrestricted asset** (e.g., land that adjoins a school and is zoned for residential or commercial use) be **reduced** to measure the current value of the restricted asset?



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18

Should a restricted operational asset's current value be reduced for the effect of the restriction?

If an **equivalent restricted asset is not obtainable** in the marketplace → apply the cost approach: market participants would be required to purchase an **equivalent unrestricted asset** to replace the asset's service potential.

View of some Australian stakeholders (FV)	IPSASB proposal / AASB tentative view
The fair value of the restricted asset (particularly if restricted land) should be reduced because market participant buyers would pay less for it than the price of the equivalent unrestricted asset (e.g., adjoining land)	The COV or fair value should not be reduced (compared with the price of an equivalent unrestricted asset) because the market participant buyer would be another NFP entity → needing to pay the (higher) price of an unrestricted asset to provide the required services



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19

Should a restricted operational asset's fair value be reduced for the effect of the restriction?

Restricted land: Consider a public sector entity that acquires land in the open market, which then becomes legally restricted (together with buildings/other improvements) and an observable market price for such restricted land does not exist.

Question 5a (AASB SMC 9-10)

If an equivalent restricted asset is **not obtainable** in the marketplace, do you think the asset's **fair value should be reduced** for the effect of the restriction?

- (a) Yes, for all types of restricted operational assets; or
- (b) No, for all types of restricted operational assets; or
- (c) Yes, for land; but no for improvements on land.



20

Should a restricted operational asset's COV be reduced for the effect of the restriction?

Question 5b (AASB SMC 9-10)

If an equivalent restricted asset is **not obtainable** in the marketplace, do you think the asset's COV **should be reduced** for the effect of the restriction?

- (a) Yes, for all types of restricted operational assets; or
- (b) No, for all types of restricted operational assets; or
- (c) Yes, for land; but no for improvements on land.



21

Application of the cost approach (applicable to both fair value and COV)



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22

Assumed location of asset measured under the cost approach

IPSASB's proposal

An asset's COV assumes that the entity will continue to meet its service delivery objectives from the **same location** in which the asset is currently situated or used.

Consider an example

Should the replacement of a war memorial site in a city's CBD be assumed to occur in a cheaper location?

Question 6 (AASB SMC 11)

Do you agree with the IPSASB's proposal that an operational asset's COV assumes that the entity will continue to meet its service delivery objectives from the **same location** in which the existing asset is situated or used?



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23

Is fair value appropriate for operational assets?

IPSASB proposes that fair value is inappropriate for operational assets → the **highest and best use** and the **maximising the use of relevant observable inputs** concepts are generally **inappropriate** for NFP public sector entities.

Question 7 (AASB SMC 18-19)

Do you agree with the IPSASB's view that fair value is inappropriate for measuring the current value of operational assets?



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24

Fair value or COV or other basis?

Question 8 (AASB SMC 18-19)

Overall, which of the following measurement bases do you consider is the best current value measurement basis for operational assets?

- a) Fair value; or
- b) Applying only the cost approach under fair value (fair value of restricted assets **not reduced for the effect of the restriction**, if an equivalent restricted asset is not obtainable in the marketplace); or
- c) Current operational value; or
- d) Another current value measurement basis.



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25

Auditing/assurance considerations for Australian NFP public sector entities in respect of COV application

Question 9 (AASB SMC 21)

- a) Would COV create any auditing or assurance challenges?
- b) Conversely, would COV reduce any auditing or assurance challenges encountered in relation to fair value measurements of operational assets?
- c) Would applying COV in measuring some operational assets and applying fair value to other non-financial assets create any auditing or assurance challenges—specifically in relation to distinguishing those asset categories?



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26

Useful links and next steps

AASB ITC 45 [Request for Comment on IPSASB Exposure Drafts ED 76 Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements and ED 77 Measurement](#)

- Comments due to AASB on this [page](#) by 3 August 2021
- AASB Board will continue its deliberations regarding the IPSASB Exposure Drafts at its August and September 2021 meetings.

IPSASB [ED 76](#) and [ED 77](#)

- Comments due to IPSASB by 25 October 2021



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27

AASB Resources



- Staff papers and research reports
- Hot Topics – guidance and reference material on the latest developments in standard setting
- YouTube channel – view AASB webinars & other recordings



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Getting Involved

Pronouncements

- ✓ identify Standards or Interpretations applicable to a reporting period

News & Alerts

- ✓ news alerts & media releases
- ✓ weekly newsletter

Outreach Events

- ✓ forums, roundtables, webcasts
- ✓ international guests & key experts

Work Program & Project Summaries

- ✓ the latest developments on AASB projects

Work in Progress

- ✓ see Exposure Drafts & AASB submissions

28

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Thank You

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