AASB Exposure Draft

ED 29X
[Month] 2020

Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity

Comments to the AASB by [date]

Note to the Board

- Staff have updated the draft ED to reflect decisions made at the Nov 2019 AASB meeting. Key changes made to the Basis of Conclusions have been marked-up in track changes to assist the Board's review.
- Comment boxes have been added throughout the document explaining the key changes made to the draft ED since the Nov 2019 version.
- Staff have included a number of specific questions for the Board as comment boxes in the draft ED.
- Staff's alternative proposal (outlined in Appendix B of Agenda Paper 11.1) on fair value measurement of concessionary ROU assets have not been reflected in the drafting of this draft ED.

Issue 1 to discuss with the Board

A Board member asked staff to check whether the title of the Standard should use the phrase 'service capacity' or 'service potential'. The Board member suggested that the title should use 'service potential' for consistency with the term used in the AASB's Conceptual Framework.

Staff observe that there are some differences between how the terms 'service capacity' and 'service potential' are used in accounting literature. In AASB's Conceptual Framework (see below) 'service potential' has been used to refer to an attribute or quality of assets, but not the quantum of assets. Whereas, in AASB 13 and AASB 136 *Impairment of Assets* the phrase 'service capacity', not 'service potential', is used when describing either the measurement or quantum of NFP entities' assets. Paragraph B8 of AASB 13 states that: "The cost approach reflects the amount that would be required currently to replace the **service capacity** of an asset (often referred to as current replacement cost)" [bolding added].

The Conceptual Framework does not use the term 'service capacity' and describes 'service potential' as a synonymous with 'future economic benefits'. Paragraph Aus49.1 of the Conceptual Framework states that: "In respect of not-for-profit entities in the public or private sector, in pursuing their objectives, goods and services are provided that have the capacity to satisfy human wants and needs. Assets provide a means for entities to achieve their objectives. Future economic benefits or service potential is the essence of assets. Future economic benefits is synonymous with the notion of service potential, and is used in this *Framework* as a reference also to service potential. Future economic benefits can be described as the scarce capacity to provide benefits to the entities that use them, and is common to all assets irrespective of their physical or other form."

Staff recommendation

Staff recommend that the title of the ED refers to 'service capacity' as this term is used in AASB 13 and AASB 136 to describe the measurement or quantum of an asset not held primarily for their ability to generate net cash inflows but held for continuing use. This term is also consistent with the terminology used in paragraph B8 of AASB 13, which describes the cost measurement approach, which is one of the key focus of this ED.

Question 1 to the Board

Do Board members agree with staff recommendation to refer the phrase 'service capacity' in the title of the ED, to be consistent with paragraph B8 of AASB 13?

Australian Government
Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

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

Formal Submissions

Submissions should be lodged online via the "Work in Progress – Open for Comment" page of the AASB website (www.aasb.gov.au/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.

WORKING DRAFT

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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.

What we are proposing

This Exposure Draft proposes amendments to AASB 13 for application by not-for-profit entities, to specify that:

(a) the fair value of a restricted, non-financial asset (including right-of-use assets arising under a concessionary leases) held primarily for its service capacity shall, in the absence of observable market evidence, be measured at its current replacement cost without a discount for the effect of the restriction(s), which is deemed to be its fair value. Disclosure of such fair value measurements would be made separately from other fair value measurements of non-financial assets;

(b) the fair value measurement of right-of-use assets arising under concessionary leases should be based on the fundamental principles for measuring the fair value of the assets they own;

(c) the 'financially feasible' aspect of a non-financial asset's highest and best use, as set out in paragraph 28(c) of AASB 13 should not apply to legally restricted non-financial assets held for their service capacity and measured at current replacement cost; and

(d) the current replacement cost of land forming part of a facility or a right to use property arising from a non-concessionary lease that, in either case, is held primarily for its service capacity should be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility or right-of-use asset to a cheaper site.

The Exposure Draft also includes Implementation Guidance and/or Illustrative Examples regarding:

(a) fair value measurement of right-of-use assets arising under concessionary leases;

(b) economic obsolescence under the cost approach;

(c) legal restrictions on the permissible uses of an asset, where the restrictions would be treated differently by different entities within a consolidated group; and

(d) the nature of costs included in the current replacement cost of a self-constructed facility.

Why we are making these proposals

Fair Value Measurement for Public Sector Entities Project

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 WoG and GGS to elect an accounting treatment that aligns with GFS principles and requirements where an accounting standard permits a choice (AASB 1049 paragraph 13). As GFS requires assets and liabilities to be measured at current market value, this has resulted in WoG and GGS electing the revaluation model as their accounting policy and measure their non-financial assets, such as property, plant and equipment, at fair value.

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

Diversity and inconsistency in applying the requirements in AASB 13

Some stakeholders from the public sector commented that applying AASB 13 *Fair Value Measurement* has been challenging and costly and there is divergence in practice on how the principles in AASB 13 have been applied and requested the AASB to provide guidance on how to measure the fair value of non-financial assets of not-for-profit public sector entities.

One of the major inconsistencies is how the principles in AASB 13 have been applied in measuring the fair value of a non-financial asset held primarily for its service capacity, which is also subject to legal restrictions on its use and on the prices that a not-for-profit entity may charge others for using the asset. In particular, it seems that many public sector entities measure the fair value of land that has been restricted in use (eg to build a hospital on it and not to be sold) at a discount to the market value of adjoining unrestricted land, while the building on the land (eg hospital building) is measured at current replacement cost without discount reflecting the restrictions. This means that component assets of a composite asset (eg hospital) are being measured using different assumptions and approaches, resulting in many cases land in these composite assets being measured at a very low values.

Inconsistent with the Conceptual Framework and misrepresentation of public sector assets

The AASB is of the view that an asset of a not-for-profit entity not held primarily to generate cash inflows, provides service potential to the entity by having the capacity to satisfy the wants and needs of members of the community (beneficiaries) without necessarily receiving cash in exchange from those beneficiaries. Consistent with paragraphs Aus49.1, Aus54.1 and Aus54.2 of the AASB's Conceptual Framework, the AASB considers that those assets should be measured at amounts faithfully representing their service potential (i.e. measured at their service capacity). By lowering the value of a restricted non-financial asset because the entity that holds the asset has restrictions to charge for services, which would diminish the net cash inflows the asset can generate directly (but the asset's service potential is unaffected) would not be consistent with the principles of the Conceptual Framework.

There is a concern that significant non-financial assets with ongoing service capacity might be written off due to restrictions imposed on the use of the asset and/or on the prices that an entity may charge others for using the asset. There is a risk that users of public sector financial statements would not get a true representation of the financial position of public sector entities from the financial statements. In particular, users would not be able to understand from the financial statements the assets being managed by the public sector entity and whether such assets have remaining service capacity. It would also be difficult for users to understand the costs required to replace the service capacity, which would make intergenerational equity difficult.

Different approaches used in other jurisdictions

The AASB observed that there appeared to be significant difference in how public sector entities in New Zealand the fair value of non-financial assets that are held primarily for their service capacity compared to the public sector entities in Australia. It seemed that a discount might be applied to reflect restrictions imposed on the use of the asset, but a discount is not applied to reflect restrictions in charging a price for use of the asset or on the restriction to sell the asset in some jurisdictions. This appeared to be different to the current practice in Australian public sector entities.

The AASB considered the feedback received and decided to address the interpretative issues regarding applying the requirements of AASB 13 to non-financial assets of not-for-profit public sector entities measured at fair value.

Extending the Project's scope to also apply to private sector not-for-profit entities

Additionally, the AASB received feedback from some not-for-profit entities in both the private sector and public sector that they are encountering difficulties as lessees in applying the principles of AASB 13 in determining the fair value of right-of-use assets arising under concessionary leases, particularly if restrictions are imposed on the use of the underlying leased asset. Concessionary leases in this context are leases with significantly below-market terms and conditions principally to enable the entity to further its objectives, as referred to in AASB 16 *Leases* and AASB 1058 *Income of Not-for-Profit Entities*.

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The AASB considered the prevalence and magnitude of concessionary leases in the not-for-profit sector, and decided to develop guidance in relation to fair value measurement of right-of-use assets arising under concessionary leases.

Who will be affected

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

Temporary relief – right-of-use assets arising under concessionary leases

The Board issued two Amending Standards: AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* and AASB 2019-8 *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases* to provide a temporary option for not-for-profit entities to measure a class of right-of-use assets arising under concessionary leases at cost or at fair value. The Board will reassess the temporary relief when it has finalised guidance to assist not-for-profit entities in measuring the fair value of right-of-use assets arising under concessionary leases.

For not-for-profit entities in the private sector, the reassessment of the temporary relief will only occur after the financial reporting framework for private sector not-for-profit entities has been finalised. At that time, the Board will consider whether to provide a permanent option for private sector not-for-profit entities to measure a class of right-of-use assets at initial recognition either at cost or at fair value for those concessionary leases entered into prior to the application date of AASB 16 or for all concessionary leases, and whether a permanent option should be provided in all financial reporting tiers of not-for-profit private sector entities or only for some.

<u>Question 2 to the Board</u>

Do Board members agree with the drafting of this section to inform private sector NFP entities that the Board will only consider removing the temporary relief after the financial reporting framework for these entities have been finalised?

Transition requirements

It is proposed that this Standard would be applied retrospectively, in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Application date

It is proposed that this Standard would be applicable to annual periods beginning on or after [a date two years after the issue of the amending Standard], with earlier application permitted.

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 the 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).

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Specific matters for comment

The AASB would particularly value comments on the following proposals made specifically in respect of non-for-profit entities:

1 Do you agree with paragraph Aus66.1(a) that the fair value of a restricted, non-financial asset held primarily for its service capacity should be measured based on the available market evidence for an equivalent restricted asset, if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence? If you disagree, please provide your reasons (see paragraphs BC33–BC36).

2 Do you agree with paragraph Aus66.1(b), as illustrated by Illustrative Example 1, that the fair value of a restricted, non-financial asset held primarily for its service capacity should be measured at its current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence? If you disagree, please provide your reasons.

3 With regard to Specific Matter for Comment 2, if you consider that the fair value of the land component of a restricted facility should be measured at a discount to the current market buying price of equivalent but unrestricted land:

(a) please identify what the discount should represent – restriction on use, restriction on price charged, restriction on both, probability that will be 'rezoned' to permit the highest and best use, other?

(b) please advise whether you agree with the AASB's conclusion that the hypothetical market participant buyer of restricted land when equivalent restricted land is unobtainable in the marketplace would be another not-for-profit entity that has similar service delivery objectives and would be willing to pay the lowest price for which it could replace the asset's service capacity. If you disagree, please explain why you consider that the market participant buyer would not be prepared to pay the replacement price of equivalent unrestricted land if there is no market evidence available that it could replace the asset for a lower price with the restriction (ie why would the market participant buyer be unwilling to pay more than the amount on which it could generate a commercial rate of return?);

(c) please advise whether land and buildings situated on that land are considered to be a composite asset with one value—and one discount—that needs to be allocated between the land and the buildings;

(d) please identify whether you consider that similarly restricted improvements on the restricted land should be measured at a similar discount to the current market buying price of equivalent unrestricted assets;

(e) if your answer to (d) is 'no', please provide your reasons for treating differently restrictions on land and similar restrictions on the improvements. In doing so, please provide your reasons:

(i) how this is consistent with the conceptual guidance on service potential and future economic benefits in paragraphs Aus49.1, Aus54.1 and Aus54.2 of the AASB Conceptual Framework; and

(ii) if the market participant buyer would be willing to pay the current replacement cost of buildings and other improvements to obtain the highest and best use of those assets, why the land under those improvements would not also be measured at the amount necessarily incurred to obtain its highest and best use; and

(f) please describe the nature of the market evidence available to support reliable estimation of the amount of the discount, both in respect of the land and improvements (see paragraphs BC27–BC66).

4 With regard to Specific Matter for Comment 2, if you disagree that the fair value of a restricted, non-financial asset held primarily for its service capacity should be measured at its current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, do you agree that, for logical consistency, amendments should be made to the requirements in AASB 1059 *Service Concession Arrangements: Grantors* and the amendment to AASB 136 *Impairment of Assets* (via AASB 2016-4 *Amendments to Australian Accounting Standards – Recoverable Amount of Non-Cash-Generating Specialised Assets of Not-for-Profit Entities*) included to ensure assets of not-for-profit entities held primarily for their service capacity are measured at amounts faithfully representing that service capacity and not their scrap values (see paragraphs BC47–BC52)?

5 With regard to paragraph Aus92.1, do you agree that a non-financial asset measured at current replacement cost in accordance with paragraph Aus66.1(b) should be disclosed separately from other non-financial assets measured at fair value? If you disagree, please provide your reasons (see paragraphs BC49–BC54).

6 Do you agree with paragraph Aus28.1 that the 'financially feasible' aspect of a non-financial asset's highest and best use, as set out in paragraph 28(c) of AASB 13, should not apply to legally restricted non-financial assets held primarily for their service capacity and measured at current replacement cost? If you disagree, please provide your reasons (see paragraphs BC67–BC68).

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7 Do you agree the current replacement cost of land forming part of a facility or a right to use a property arising from a non-cancellable lease that, in either case, is held for its service capacity should be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility or right-of-use asset to a cheaper site (see paragraph F26)? If you disagree, please provide your reasons (see paragraphs BC101–BC111).

8 In respect of paragraph F20–F23 and Illustrative Example 2, do you agree that if a government can rescind a law or regulation restricting the use (or pricing of the use) of a non-financial asset held by an entity it controls and does not require parliamentary approval for that rescission, the government should not measure the fair value of that asset assuming the restriction would necessarily pass to the market participant buyer, even when its controlled entity is required to assume in its own financial statements that the restriction would pass to the market participant buyer? If you disagree, please provide your reasons. Please provide details of the relative costs and benefits of obtaining and reporting different fair value measurements of the same asset at different levels of a consolidated group (see paragraphs BC71–BC79).

9 In respect of Illustrative Example 3, do you agree it appropriately reflects the calculation of the current replacement cost of a self-constructed facility by:

(a) being calculated on the assumption that the facility does not presently exist and requires replacing in the facility's current environment;

(b) including all necessary costs intrinsically related to acquiring the facility at the measurement date; and

(c) taking into account any make-good costs that must be incurred for surrounding facilities of another entity disturbed when the entity's facility is replaced?

If you disagree, please provide your reasons (see paragraphs BC80–BC89).

10 Regarding external (ie economic) obsolescence of a non-financial asset (or facility) measured under the cost approach, do you agree with the proposals in paragraphs F24–F25 and Illustrative Examples 4 and 5 that:

(a) if the asset (or facility) has suffered a reduction in demand for its services, the identification of its economic obsolescence does not require a formal decision to have been made to reduce the physical capacity of that asset (or facility); and

(b) if the asset (or facility) has apparent overcapacity in view of current demand for its services, economic obsolescence shall not be identified for that asset (or facility) 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?

If you disagree, please provide your reasons (see paragraphs BC90–BC92).

11 When different functionally related assets are subject to different legal restrictions on their use or the prices that may be charged for using them (as illustrated in proposed Illustrative Example 11), do you agree that such a 'composite asset' would rarely include both of the following categories (which would be required to be disclosed separately):

(a) one or more components that qualify to be measured at fair value solely in accordance with paragraph Aus66.1(a)—because equivalent restricted assets are obtainable in the marketplace for a price supported by observable market evidence; and

(b) other components that qualify to be measured at fair value (ie based on their current replacement cost, which is deemed to be their fair value) in accordance with paragraph Aus66.1(b)—because equivalent restricted assets are not obtainable in the marketplace for a price supported by observable market evidence?

If you disagree, please provide your reasons. In addition, regardless of whether you agree or disagree, please provide information about the prevalence of such 'composite assets' to assist the Board in assessing whether Australian Implementation Guidance for Not-for-Profit Entities should be developed in respect of them (see paragraphs BC93–BC100).

12 Do you agree the proposals in this Exposure Draft should apply to not-for-profit entities in both the public sector and private sector? If you disagree, please provide your reasons (see paragraph BC23).

Right-of-use assets arising under concessionary leases

13 Do you agree with applying the same fundamental principles for measuring the fair value of owned assets, as set out in paragraphs 61–66 of AASB 13 and the proposed paragraphs Aus66.1–Aus66.2, in measuring the fair value of right-of-use assets arising under concessionary leases and held primarily for their service capacity? If you disagree, please provide your reasons (see paragraphs BC117–BC130).

14 In respect of legally restricted right-of-use assets arising as lessees under concessionary leases and held primarily for their service capacity, do you agree with:

(a) the rebuttable presumption that, unless exceptional circumstances exist, the current replacement cost of such a right-of-use asset (deemed to be its fair value under paragraph Aus66.1(b)) can be measured reliably;

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(b) the explicit criteria in paragraph Aus66.2 for when the presumption in (a) can be rebutted (see paragraphs BC127–BC129); and

(c) if the presumption in (a) is rebutted, the right-of-use asset should initially be measured at the same amount as the lease liability? If you disagree, please identify how the fair value of the right-of-use asset should be measured and provide your reasons.

If you disagree, please provide your reasons (see paragraphs BC125–BC130).

15 Do you agree with the proposed Illustrative Examples 6–10 regarding fair value measurement of lessees' right-of-use assets held primarily to provide service capacity under concessionary leases? If you disagree, please provide your reasons. Please include your views regarding the relevance of the fact patterns in those illustrative examples to the environment in which you operate.

Other specific matters for comment

16 Do you agree the mandatory effective date of the proposals should be the first annual period beginning <u>two years after the issue of the amending Standard?</u> If you disagree, please provide your reasons (see paragraphs BC142–BC143).

17 Do you agree with the proposed requirement in paragraph AusC8 to apply the amendments in this proposed Standard retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*? If you disagree, please provide your reasons. Whether you agree or disagree, where possible, please provide any quantitative or qualitative information relevant to the Board's assessment of the costs and benefits of retrospective application of the new requirements (see paragraphs BC144–BC151).

General matters for comment

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

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

19 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?

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

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

22 Whether the proposals create any auditing or assurance challenges?

23 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.

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<u>Question 3 to the Board</u>

Do Board members have any comments on the Specific Matters for Comment?

Contents

[Draft] Australian Accounting Standard AASB 2020-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity* is set out on pages 11–16. All the paragraphs have equal authority.

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Preface

Standards amended by 2020-X

This [draft] Standard makes amendments to AASB 13 *Fair Value Measurement* (August 2015) for application by not-for-profit entities and related authoritative implementation guidance, including guidance on fair value measurement of right-of-use assets arising under concessionary leases.

Main features of this Standard

Main requirements

This [draft] Standard amends AASB 13 for application by not-for-profit entities, to specify that:

(a) the fair value of a restricted, non-financial asset (including right-of-use assets arising under a concessionary leases) held primarily for its service capacity should, in the absence of observable market evidence, be measured at its current replacement cost without a discount for the effect of the restriction(s), which is deemed to be its fair value. Disclosure of such fair value measurements would be made separately from other fair value measurements of non-financial assets;

(b) the fair value measurement of right-of-use assets arising under concessionary leases should be based on the fundamental principles for measuring the fair value of the assets they own;

(c) the 'financially feasible' aspect of a non-financial asset's highest and best use, as set out in paragraph 28(c) of AASB 13 should not apply to legally restricted non-financial assets held for their service capacity and measured at current replacement cost; and

(d) the current replacement cost of land forming part of a facility or a right to use property arising from a non-concessionary lease that, in either case, is held primarily for its service potential should be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility or right-of-use asset to a cheaper site.

The Exposure Draft also includes Implementation Guidance and/or Illustrative Examples regarding:

(a) fair value measurement of right-of-use assets arising under concessionary leases;

(b) economic obsolescence under the cost approach;

(c) legal restrictions on the permissible uses of an asset, where the restrictions would be treated differently by different entities within a consolidated group; and

(d) the nature of costs included in the current replacement cost of a self-constructed facility.

Application date

This [draft] Standard applies to annual periods beginning on or after [a date two years after the issue of the amending Standard], with earlier application permitted.

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[Draft] Accounting Standard AASB 2020-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2020-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity* under section 334 of the Corporations Act 2001.

Kris Peach

Chair – AASB

Dated … [date]

[Draft] Accounting Standard AASB 2020-X
Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity

Objective

1 This Standard amends AASB 13 *Fair Value Measurement* (August 2015) to add authoritative implementation guidance for application by not-for-profit entities and to make related amendments to AASB 13 as set out in paragraphs 5–8 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 [a date two years after the issue of the Standard]. This Standard may be applied to annual periods beginning before [date to be specified]. 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 Aus28.1, Aus66.1, Aus66.2 and Aus92.1 are added. Paragraphs 28 and 61–66 have not been amended but have been included for ease of reference.

…

Application to non-financial assets

Highest and best use for non-financial assets

…

28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

<u>**Explanation of changes made to the Nov 2019 version**</u>

Staff have made amendments to the proposed paragraphs Aus28.1, Aus66.1 and Aus66.2 and added paragraph Aus92.1 to address the following Board decisions to:

1. Incorporate the notion of 'deemed to be fair value' for measurement of restricted assets at CRC without discount for the restriction. This is to signify that this method of measurement might not be compliant with IFRS 13.
2. Require separate disclosure of restricted assets (and their amounts) deemed to be measured at fair value.
3. Specify the fundamental fair value measurement principles applicable to owned assets are to be applied to ROU assets under concessionary leases.

Since the Board has decided to introduce the notion of 'deemed to be fair value' in AASB 13, the previous proposed amendments to AASB 116 *Property, Plant and Equipment* are no longer required and have been removed in this version.

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(c) 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.

Aus28.1 Notwithstanding paragraph 28, the highest and best use of a non-financial asset of a not-for-profit entity need not be 'financially feasible' (as described in paragraph 28(c)) if the asset is held primarily for its service capacity and measured in accordance with paragraph Aus66.1(b).

…

Valuation techniques

…

61 An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarised in paragraphs B5–B11. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.

63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

64 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 or liability 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 or liability) at the measurement date.

65 Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (eg a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place: (a) new markets develop; (b) new information becomes available; (c) information previously used is no longer available; (d) valuation techniques improve; or (e) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with AASB 108. However, the disclosures in AASB 108 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Aus66.1 Notwithstanding paragraphs 61–66, to measure the fair value of a non-financial asset of a not-for-profit entity held primarily for its service capacity, if the asset has a legally restricted use or is subject to a legal restriction on the prices that may be charged for using it and:

(a) an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is measured at fair value based on the available market evidence for the equivalent restricted asset; or

(b) an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is, subject to paragraph Aus66.2, measured at its current replacement cost without a discount to the

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current market buying price of an equivalent but unrestricted asset, which is deemed to be its fair value.

Aus66.2 There is a rebuttable presumption that a not-for-profit entity that is a lessee can reliably measure the current replacement cost of its right-of-use asset under a lease with significantly below-market terms and conditions principally to enable the entity to further its objectives. The fundamental principles set out in paragraphs 61–Aus66.1 shall be applied in measuring the current replacement cost of such right-of-use assets. However, if, in exceptional cases, there is clear evidence when an entity first acquires a right-of-use asset that the current replacement cost of the right-of-use asset cannot be measured reliably, the entity shall initially measure such a right-of-use asset at the same amount as the lease liability. This circumstance arises when, and only when:

(a) neither an equivalent right-of-use asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, nor are alternative reliable estimates of current replacement cost (eg based on discounted cash flow projections) available; or

(b) the current replacement cost of the right-of-use asset can only be estimated by reference to available evidence of the current replacement cost of the underlying asset that is the subject of the lease, and evidence of the difference between the current replacement cost of the underlying asset and of the right-of-use asset is unavailable. This occurs when and only when:

(i) the underlying asset creates valuable rights other than rights of use and the current replacement cost of those additional rights cannot be estimated reliably; or

(ii) the lease term is materially shorter than the estimated economic life of that underlying asset and, because in the entity's specific circumstances the pattern of consumption of the underlying asset's service capacity cannot be estimated reliably, it is impossible to determine the portion of the underlying asset's current replacement cost that is attributable to the right-of-use asset.

…

Disclosure

…

Aus92.1 Notwithstanding paragraph 92, in respect of not-for-profit entities, the assets deemed to be measured at fair value in accordance with paragraph Aus66.1(b), and their amounts, shall be disclosed separately from other assets measured at fair value.

Explanation of changes made to the Nov 2019 version

Staff have made amendments to the proposed paragraph Aus66.2, regarding measurement of concessionary ROU assets to specify:

1. there is a rebuttable presumption that the CRC of ROU assets under concessionary leases can be reliably measured (similar to AASB 140 *Investment Property*); and
2. in rare circumstances where the CRC cannot be reliably measured, measure the ROU asset under concessionary leases at the same amount as the lease liability.

Question 4 to the Board

Do Board members agree with the drafting of paragraphs Aus28.1, Aus66.1, Aus66.2 and Aus92.1?

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6 Paragraphs AusC7–AusC9 are added to Appendix C *Effective date and transition*.

Appendix C

Effective date and transition

…

AusC7 AASB 2020-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity* issued in [date], added paragraphs Aus28.1, Aus66.1, Aus66.2 and Aus92.1 to the previous version of this Standard. A not-for-profit entity shall apply those amendments and the accompanying Appendix F *Australian implementation guidance for not-for-profit entities* for annual periods beginning on or after [a date two years after the issue of the amending Standard]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. AASB 2020-X also added *Australian illustrative examples for not-for-profit entities* to accompany AASB 13.

AusC8 A not-for-profit entity shall apply the amendments in AASB 2020-X retrospectively, in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The amendments shall not be applied to items that have already been derecognised at the date of initial application.

7 Appendix F *Australian implementation guidance for not-for-profit entities* is added as set out on pages X-X of this Standard.

~~1.~~ *Australian illustrative examples for not-for-profit entities* is attached to accompany AASB 13 as set out on pages X-X of this Standard.

Note: Retrospective application under AASB 108 would require NFP entities to restate comparative information and prepare disclosures under paragraph 28 of AASB 108, which includes disclosure of the amount of the adjustment for each financial statement line item affected for the current period and each prior period presented.

Explanation of changes made to the Nov 2019 version

Staff have made amendments to the drafting of transition requirements to reflect the following Board decisions:

1. The amending Standard should apply to annual periods two years after its issue, with early application permitted.
2. The Standard shall be applied retrospectively and require restatement of comparative information.
3. The amendment should be applied in full and not progressively (as originally suggested by staff).

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8

Commencement of the legislative instrument

9 For legal purposes, this legislative instrument commences on … [date].

Issue 2 to discuss with the Board

At its November 2019 meeting, the Board tentatively decided that the proposed amendments should be applied retrospectively under AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, the transitional provisions in AASB 13 require prospective application, not retrospective application. This is because, as stated in paragraph BC229 of the 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)."

The Board's tentative decision to propose requiring retrospective application of the NFP amendments to AASB 13 reflected the views of Board members that retrospective application enhances inter-period comparability and, in respect of prior period information presented, the discount to the current replacement cost (CRC) of equivalent but unrestricted assets would have been documented and therefore capable of 'reversal'. However, staff suggest that the Board deliberates this issue further in light of:

(a) the general principle of prospective application in the existing AASB 13 (which particularly reflects the IASB's concern that changes upon adopting that Standard would be indistinguishable from changes in accounting estimates);
(b) the potential that adopting the amendments would involve changes other than the removal of discounts for the effect of restrictions (eg: adopting the cost approach instead of the market approach or income approach to measure the fair value of particular assets, about which determining comparative amounts might necessarily involve the use of hindsight; including make-good costs in CRC when they were not estimated in prior periods; and changing the assumed location of land from that assumed in prior period estimates of CRC); and
(c) information about the value of lessees' right-of-use assets under concessionary leases for prior periods might be unavailable.

Moreover, in recent conversations with some stakeholders in the NFP public sector, it became apparent that the proposals might impact a larger number of public sector assets than initially anticipated. They mentioned that it is common in the public sector that the fair value of a restricted piece of land (eg hospital land) be measured at a discount to the market value of adjoining unrestricted land, while the restricted building (eg hospital building) on the land is measured at CRC. Under the proposals, the measurement of such restricted land would have to be changed (to be measured at CRC in accordance with paragraph Aus66.1(b), without a discount to the market value of adjoining unrestricted land). These stakeholders informed that this would impact many public sector entities as the current accounting treatment to such restricted land has been applied across the Australian public sector.

Staff recommendation

Staff think that, in view of the range of proposed amendments that might be impracticable to apply retrospectively and the potentially large quantum of public sector assets impacted, it might be more appropriate to propose requiring the proposed amendments to be applied prospectively. The draft discussion of the transitional provisions, based on the Board's discussion at its November 2019 meeting, is set out in paragraphs BC142-BC151 of the draft Basis for Conclusions.

Question 5 to the Board:

Do Board members agree with staff recommendation to reconsider its tentative decision to require the proposed amendments to be applied retrospectively?

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

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 has prepared this appendix to explain and illustrate the application of the principles of paragraphs 61 – 66 and Aus66.1 – Aus66.2 of the Standard by not-for-profit entities in the public and private sectors, in relation to fair value measurement of non-financial assets. The appendix does not apply to for-profit 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 held primarily for their service capacity

F3 Many non-financial assets of not-for-profit entities are held primarily for their service capacity, including right-of-use assets arising from leases with significantly below-market terms and conditions principally to enable the entity to further its objectives. According, many of these assets are subject to restrictions on their use (eg the asset's use is limited to a specific purpose) and/or on the prices charged for using the asset. Therefore, in many circumstances, the only market participants of such restricted assets would be another not-for-profit entity with similar service delivery objectives, requiring the restricted asset to deliver a similar service. That is, a market participant of such assets would not be a for-profit entity because a for-profit entity would not ordinarily purchase an asset with restrictions that limit its ability to generate cash flows that would not enable a commercial rate of return.

F4 In accordance with paragraph 11 of the Standard, when measuring the fair value of an asset an entity would only take into account those characteristics of the asset, such as restrictions, that market participants would take into account when pricing the asset at the measurement date. Since the market participant buyer of assets described in paragraph F3 will be another not-for-profit entity with similar service delivery objectives, the market participant buyer would be willing to (or economically required to) pay for an asset it requires to fulfil its service delivery objectives (even if it cost more than the amount on which it can generate a commercial rate of return). That is, a market participant buyer of such restricted assets would not take into account the restrictions imposed on the asset when pricing the asset at the measurement date, if the restrictions merely formalise expectations that the entity will pursue its service delivery objectives with the asset. In this case, unless an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the restrictions should not be considered when measuring the amount deemed to be the fair value of such restricted assets.

F5 Since the focus of a not-for-profit entity when measuring the fair value of its non-financial asset held primarily for their service capacity is not on the asset's ability to generate net cash inflows, the market approach or the income approach shall not be applied to measure the fair value of such assets. This is because both the market approach and the income approach assume a market participant buyer would hold the asset to generate a commercial rate of return. A not-for-profit entity shall apply the cost approach in measuring the amount deemed to be the fair value of such assets. The cost approach would reflect the cost required for a not-for-profit entity market participant buyer to replace the remaining service capacity of asset at the measurement date (ie current replacement cost). This is consistent with paragraphs Aus49.1, Aus54.1 and Aus54.2 of the AASB's Conceptual Framework, to measure such assets at amounts faithfully representing their service potential.

Fair value of non-financial assets

F6 Under paragraphs 61–66, Aus66.1–Aus66.2 and F3–F5, for non-financial assets held by not-for-profit entities (including right-of-use assets of lessees under leases with significantly below-market terms and conditions principally to enable the entity to further its objectives):

<u>Explanation of changes made to the Nov 2019 version</u>

Staff have added Implementation Guidance to reflect the Board's decisions relating to:

1. fair value measurement of concessionary ROU assets;
2. treatment of legal restrictions imposed on asset at different levels of a consolidated group;
3. economic obsolescence of assets measured at current replacement cost; and
4. location of land forming part of a facility measured at current replacement cost.

(a) if an asset is held primarily for its ability to generate net cash inflows, its fair value is measured using whichever of the market approach, cost approach or income approach (or a combination of them) is the most appropriate in the circumstances. This is an unmodified requirement of AASB 13;

(b) if an asset is held primarily for its service capacity (ie not held primarily for its ability to generate net cash inflows), and the asset has neither a legally restricted use nor is subject to a legal restriction on the prices that may be charged for using it, its fair value is measured using whichever of the market approach, cost approach or income approach (or a combination of them) is the most appropriate in the circumstances. This is also an unmodified requirement of AASB 13; and

(c) if an asset is held primarily for its service capacity, and the asset has a legally restricted use or is subject to a legal restriction on the prices that may be charged for using it and:

 (i) an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is measured at fair value based on the available market evidence for the equivalent restricted asset; or

 (ii) an equivalent restricted asset (see paragraph F14) is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is, subject to paragraph Aus66.2, measured at its current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset, which is deemed to be its fair value. In these circumstances it is considered the only market participant buyer would be another not-for-profit entity with the same service capacity requirement. Consistent with paragraphs F4–F5, because of the nature of the restrictions, the not-for-profit market participant buyer would be economically required to replace the asset in its current condition and location. The best reflection of the remaining service capacity of the asset is its current replacement cost, rather than a the price on which a for-profit entity could generate a commercial return (reflected in application of either the market approach or income approach in paragraph 62).

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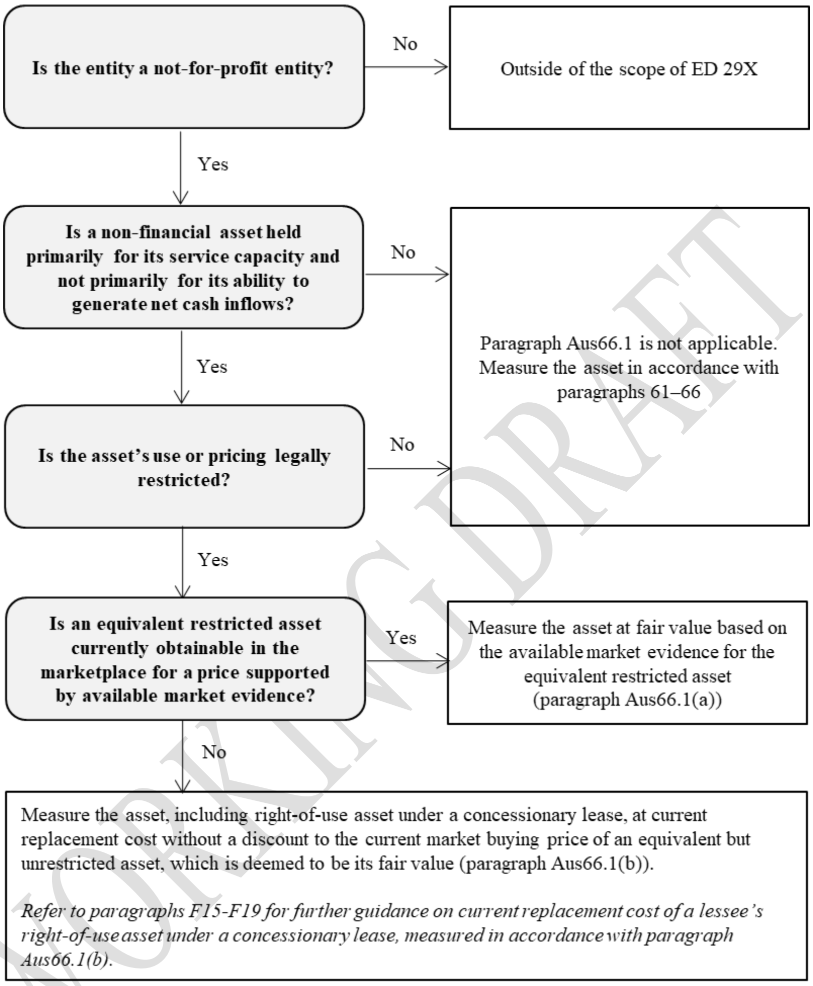
F7 The flowchart below summarises the principles in AASB 13 applied by not-for-profit entities in determining the appropriate valuation technique to use when measuring the fair value of their non-financial assets.



WORKING DRAFT

F8 In accordance with paragraphs 28 and Aus28.1, a not-for-profit entity measuring the fair value of a non-financial asset held primarily for its service capacity in accordance with paragraph Aus66.1 and paragraph F6, the highest and best use of the non-financial asset shall takes into account the use of the asset that is physically possible and legally permissible. A 'legal restriction' on a non-financial asset refers to a legally enforceable restriction on the asset's use or the prices that may be charged for using it that:

(a) cannot be revoked by the not-for-profit entity holding the non-financial asset; and

(b) would be transferred to any market participant buyer of the asset.

F9 A legal restriction can arise from legislation, ministerial decisions or instructions from Governments or other authorities. In the public sector, various legal requirements stipulating how a non-financial asset may be used or the prices that may be charged for using the asset would not (subject to paragraph F13) qualify as 'legal restrictions' affecting the highest and best use of the asset, because they are either 'self-imposed' (ie they can be revoked at any time at the absolute discretion of the public sector entity recognising them) or only apply while the asset continues to be held by that entity.

Staff noted that New Zealand public sector entities treat restrictions on land as non-binding, unless the restriction is in the title of the land that would be transferred to any purchaser. Therefore, most restrictions (eg restrictions on prices that might be charged for using the asset) are not considered when measuring the fair value of non-financial assets as they are considered as self-imposed restrictions and capable of being changed.

Question 6 to the Board

Do Board members agree with the drafting of paragraphs F8–F11, regarding the meaning of a 'legal restriction'?

F10 If a non-financial asset of a public sector not-for-profit entity (eg a government) measured at fair value is subject to a legal stipulation regarding its use or the prices that may be charged for using it, and that legal stipulation:

(a) would be transferred to any market participant buyer of the asset;

(b) can only be rescinded by parliament; and

(c) has yet to be rescinded,

the legal stipulation is treated a present legal restriction when measuring the asset's fair value in the financial statements of that entity.

F11 However, in accordance with paragraph Aus66.1(a), a legal restriction would only affect the measurement of the fair value of the non-financial asset if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence. That is, a stipulation is taken into account in the measurement of a non-financial asset's fair value if, and only if, both of the following criteria are satisfied:

(a) the stipulation is a present legal restriction; and

(b) an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

F12 In relation to paragraph F10, if a rescission of a restriction has been approved by one House of Parliament but requires approval by another House of Parliament, or requires Royal Assent, the restriction is treated as still requiring rescission by parliament, and therefore treated as a present legal restriction.

F13 If the public sector not-for-profit entity referred to in paragraph F10 can rescind the restriction without parliamentary approval, it treats the restriction as non-legally binding. The measurement of the asset's fair value reflects the present existence of the restriction, but also the option to rescind the restriction. This is achieved by measuring the asset as if it were unrestricted but then reducing its fair value estimate for the effects of:

(a) the risk that the entity will be unable to rescind the restriction; and

(b) the current cost (if any) of rescinding the restriction, if it could be rescinded. These costs of rescission would include the costs of preparing the legal instrument effecting the rescission, the costs of notifying interested parties (where appropriate, eg where the intended rescission could be challenged at law) and the costs of any court action necessary to defend the rescission (eg in an Environment Court). These rescission costs exclude the costs of converting an asset's use from its existing use to a higher and better use: those costs are separately factored into the asset's fair value estimate according to the approach adopted under paragraphs 61 – 66, as modified by paragraphs Aus66.1–Aus66.2.

However, if there is a significant risk of being unable to rescind a restriction and the risk cannot be estimated reliably, the restriction is wholly taken into account in the asset's fair value measurement if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence (see paragraph Aus66.1(a)).

F14 For the purposes of paragraphs Aus66.1, F6(c), F11–F13 and F20–F23, an equivalent restricted asset is an asset subject to the same restriction(s) on use or pricing as the entity's asset being measured and provides the same services as those the entity's asset provides in its existing use. If the equivalent asset has a different amount (although necessarily the same nature) of service capacity as the asset being measured, market comparison techniques are used to adjust for the difference between the capacity of the entity's asset being measured and the capacity of the equivalent reference asset. For example, a not-for-profit entity measures a parcel of restricted land using the price per square metre in a recent market transaction for a nearby parcel of land twice its size (adjusted for any difference in value if the shape of the reference asset provides slightly different amenity). Despite being a different size, the nearby parcel of land is an equivalent asset because it provides the same services as the land being measured. This is illustrated in respect of owned restricted land or rights to use restricted land in Illustrative Example 7 (pertaining to paragraph F6(c)(i)) and Illustrative Examples 1 and 9 (pertaining to paragraph F6(c)(ii)).

WORKING DRAFT

Fair value of lessees' right-of-use assets under leases with significantly below-market terms and conditions principally to enable the entity to further its objectives

Current replacement cost of a lessee's right-of-use asset (Aus66.1(b))

F15 In regard to paragraph F6(c)(ii), when the current replacement cost of a lessee's right-of-use asset arising under a lease with significantly below-market terms and conditions principally to enable the entity to further its objectives is deemed to be the asset's fair value:

(a) the current replacement cost of the lessee's right-of-use asset shall be calculated as the present value of the market rentals for using the underlying asset, discounted at a market-based asset-specific rate of discount, if observable evidence for estimating those market rentals is available; or

(b) if observable evidence for estimating market rentals for using the underlying asset is not available, as a practical expedient; the current replacement cost of the lessee's right-of-use asset shall be measured at:

(i) the fair value of the asset underlying the lease, if the lease term is materially the same as the remaining economic life of the underlying asset; or

(ii) the fair value of the asset underlying the lease, adjusted to reflect the lease term relative to the remaining economic life of the underlying asset, if the lease term is not materially the same as the remaining economic life of the underlying asset.

F16 In respect of the practical expedient in paragraph F15(b) in calculating the current replacement cost of the lessee's right-of-use asset, if observable market evidence is readily available that the underlying asset conveys to a market participant buyer valuable rights other than the right to use it, the fair value of those other rights arising from ownership of the underlying asset shall be excluded from the fair value of the underlying asset (eg an adjustment is made to reflect the probability of a capital gain of the underlying asset). An entity need not undertake an exhaustive search to ascertain whether other valuable rights are conveyed by ownership of the asset underlying the lease.

F17 As mentioned in paragraph B55 of AASB 16, land normally has an indefinite economic life. For the purposes of applying the practical expedient in paragraph F15(b) if the asset underlying the lease include land, the remaining economic life of the land shall be deemed to be 99 years.

F16 The guidance in paragraphs 18-21 and B34–B41 of AASB 16 applies in determining the non-cancellable lease term of the contract. B35 indicates that if only the lessor has the option to terminate a lease, the lessee ignores the lessor's right to terminate the lease when determining the non-cancellable lease term. However, in respect of the fair value measurement of right-of-use assets for the purposes of paragraph F15, as a practical expedient, from the lessee's perspective, if the lessor of a lease with significantly below-market terms and conditions principally to enable the lessee to further its objectives has an unconditional right to terminate a lease without cause at any time (or other terms economically similar):

(a) if the not-for-profit entity lessee has few such leases, the fair value of its right-of-use asset under the lease(s) is deemed to be immaterial; or

(b) if the not-for-profit entity lessee has more than a few such leases, it measures the fair value of its right-of-use assets as a portfolio of leases and estimating the probability overall for the portfolio that leases will not be cancelled.

Note to the Board

Some valuers have indicated that if the lessor has the right to terminate a concessionary lease without cause, the fair value of the concessionary ROU asset would be low because of the uncertainty of the term.

F18 Under paragraph Aus66.2, in exceptional circumstances, if a not-for-profit entity lessee cannot measure reliably the current replacement cost of its right-of-use asset held primarily for its service capacity under a lease with significantly below-market terms and conditions principally to enable the entity to further its objectives, it initially measures that asset at the same amount as the lease liability.

F19 The flowchart below summarises the principles set out in paragraph F15 for estimating the current replacement cost of a lessee's right-of-use asset arising under a lease with significantly below-market terms and conditions principally to enable the entity to further its objectives, in accordance with paragraph Aus66.1(b).

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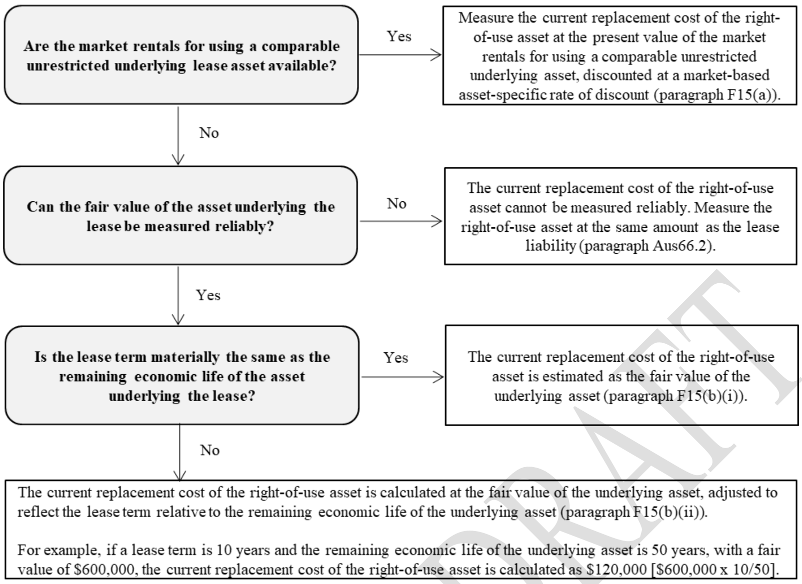

Legal restrictions on the use of an asset or prices charged for using the asset: identification at different levels of a consolidated group

F20 If a non-financial asset of a public sector not-for-profit entity measured at fair value is subject to a legal stipulation regarding its use or the prices that may be charged for using it, and that legal stipulation:

(a) was imposed by its parent entity (eg whole of government);

(b) can only be rescinded by parliament;

(c) would be transferred to any purchaser of the asset; and

(d) has yet to be rescinded,

the legal stipulation is treated as a present legal restriction when measuring the asset's fair value in the consolidated financial statements of the parent entity as well as the financial statements of the controlled entity. However, in accordance with paragraph Aus66.1(a), that legal restriction would only affect the measurement of the fair value of the non-financial asset if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

F21 If a non-financial asset held by a controlled public sector not-for-profit entity is presently subject to a stipulation concluded to be a present legal restriction only at a controlled entity level, different fair value measurements of the asset would be made at the controlled entity and group level if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence. In these circumstances:

(a) the stipulation (ie present legal restriction for the controlled entity) is wholly taken into account in the asset's fair value measurement in the financial statements of the controlled entity; and

(b) the parent entity measures the asset's fair value without taking the stipulation wholly into account, in accordance with paragraph F13, unless if there is a significant risk of being unable to rescind the stipulation and the risk cannot be estimated reliably. If both the parent entity's risk of being unable to rescind the stipulation and the current cost of rescinding the stipulation are insignificant, the deduction for the effect of the legal stipulation would be likely to be immaterial, ie the parent entity could measure the fair value of the asset without making any adjustment for the effect of the stipulation.

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F22 If, in the circumstances in paragraph F21, a legal stipulation is concluded to be a present legal restriction only at a controlled entity level, the different fair value measurements of the asset at the controlled entity and group level would require a consolidation adjustment when preparing the consolidated financial statements for the parent.

F23 However, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset would, in accordance with paragraph Aus66.1(b), be measured at its current replacement cost (which is deemed to be the asset's fair value) without a discount to the current market buying price of an equivalent but unrestricted asset. Therefore, the restriction would have no effect on the measurement of the asset's fair value in the financial statements of either the controlled entity or its parent entity, despite being legally binding only at the controlled entity level.

Economic obsolescence of assets measured at current replacement cost

F24 When a non-financial asset (or facility) held by a not-for-profit entity and measured at current replacement cost in accordance with paragraph F6(a), (b) or (c) has suffered a reduction in demand for its services, the identification of 'external (ie economic) obsolescence' (referred to in paragraph B9) in respect of that asset (or facility) does not require a formal decision to have been made to reduce the physical capacity of that asset (or facility).

F25 When a non-financial asset (or facility) held by a not-for-profit entity and measured at current replacement cost in accordance with paragraph F6(a), (b) or (c) has apparent overcapacity in view of current demand for its services, economic obsolescence shall not be identified for that asset (or facility) 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.

Location of real property measured at current replacement cost

F26 When land forming part of a facility, or a right to use office premises, held by a not-for-profit entity primarily for its service capacity is measured at its current replacement cost in accordance with paragraph F6(a), (b) or (c), that real property asset is measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility or right-of-use asset to a cheaper site.

Explanation of changes made to the Nov 2019 version

At the Nov 2019 meeting, the Board decided that the CRC of land forming part of a facility held for its service capacity would always be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility to a site with cheaper land.

Accordingly, staff have updated paragraphs F26 and BC101–BC111 to reflect this decision.

Question 7 to the Board

Do Board members agree with the drafting of Appendix F?

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Australian illustrative examples for not-for-profit entities

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

These examples illustrating aspects of the Australian guidance for not-for-profit 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 entity might apply some of the 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.

Valuation techniques – Assets held primarily for their service capacity rather than their ability to generate net cash inflows (paragraph Aus66.1)

IE2 Example 1 illustrates the application of paragraph Aus66.1 and the elaboration of how to apply that principle set out in Appendix F (Australian implementation guidance).

Example 1 – Assets held primarily for their service capacity

A local council (Bayview Council) recently purchased a parcel of residential land for $30 million, which was rezoned as parkland. The local government does not have the power to rezone the land (that power resides with the State Government's Planning Minister). Land restricted for use as a park in a suitable location and with similar characteristics is not obtainable in the marketplace. At Bayview Council's reporting date, there have been no changes in the market price of land in the area since the parkland was acquired, and the market value of a similarly sized parcel of adjacent residential land is $30 million.

A restaurant was built on the parkland with the primary purpose of generating net cash inflows from lessees of the restaurant. In addition, barbecues, picnic facilities and a shelter were built on the parkland to provide services to park visitors (ie for their service capacity).

<u>Valuation techniques</u>

Bayview Council would measure the parkland and the improvements on that land (excluding the restaurant) at current replacement cost (which is deemed to be their fair value), in accordance with paragraph Aus66.1(b), because those assets are held primarily for their service capacity and because land restricted for use as a park in a suitable location and with similar characteristics is not obtainable in the marketplace. In accordance with paragraph Aus66.1(b), the restricted parkland's current replacement cost is not measured at a discount to the current price of suitable unrestricted land that would be purchased in a replacement transaction. Based on the current market price of adjacent residential properties, the current replacement cost of the parkland at the reporting date is estimated as $30 million.

The restaurant's fair value is measured separately from the current replacement cost of the parkland, taking care not to double-count the value of the land under the restaurant, because the restaurant is held with the primary purpose of generating net cash inflows—that is, paragraph Aus 66.1 does not apply to it (see also paragraph F6(a) of the Australian Implementation Guidance for Not-for-Profit Entities). Bayview Council would use judgement in selecting an appropriate valuation technique under paragraphs 61 – 66 of AASB 13. Because the restaurant is capable of generating net cash inflows separately from the parkland, Bayview Council concludes that either the income approach or the market approach would be appropriate to measure the fair value of the restaurant. Bayview Council takes into account estimates under each of those approaches, maximising the use of relevant observable inputs to the fair value estimate (in accordance with paragraph 61 of AASB 13).

<u>Explanation of changes made to the Nov 2019 version</u>

Examples 1–5 were presented to the Board at the Nov 2019 meeting. Other than editorial changes, no changes have been made to the technical content of these examples.

Staff have added Illustrative Examples to demonstrate how the proposals would apply to:

- concessionary ROU assets (Examples 6-10);
- and composite asset (Example 11).

Previous examples on current replacement cost of land has been removed as it was decided at the Nov 19 meeting that CRC of land forming part of a facility held for its service capacity would be measured by assuming it is replaced in its present location.

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Highest and best use for non-financial assets

Legally permissible uses of an asset (paragraph 28(b))

IE3 Example 2 illustrates whether legal stipulations might be treated differently at a parent entity level (e.g. State Government level), compared with an individual entity (e.g. government department) level, when those restrictions were imposed by the parent entity.

Example 2 – Legal restrictions on the use of an asset treated differently at different levels within a group

At 30 June 20X0 (the reporting date), the Department of Infrastructure held a parcel of vacant land adjacent to an inner suburban railway station that its State Government has legally restricted for use as a parking lot pending a long-term decision on its best use. If the Department sold the parcel of land at the reporting date, the restriction over the land's restricted use would transfer to the market participant buyer. The State Government's Planning Minister can rescind the restriction through an administrative order (ie without parliamentary approval).

The Department concludes that the restricted land is held primarily to generate net cash inflows because the State Government has privatised the delivery of commuter parking services.

<u>Treatment of the legal restriction at the level of the Department of Infrastructure</u>

The Department of Infrastructure cannot rescind the legal restriction because the power of rescission vests in the Planning Minister. Therefore, the legal restriction would transfer to a market participant buyer of the parcel of land from the Department. Accordingly, the Department measures the fair value of the parcel of land as at 30 June 20X0 by taking the legal restriction into account in identifying the land's highest and best use, in accordance with paragraph 28(b) of AASB 13.

Valuation technique

The Department concludes that the income approach described in paragraphs B10 – B30 of AASB 13 is the most appropriate for measuring the fair value of the land, taking into account the best estimate of the present value of the parking fees the land will generate after deducting the cost to a market participant buyer to convert the vacant land to a car park. Using this approach, the land's fair value is estimated at $2.8 million. This estimate is corroborated by observable market data for a nearby parking station operated by a private company. Therefore, the Department measures the land's fair value at $2.8 million.

<u>Treatment of the legal restriction at the level of the State Government</u>

The State Government can rescind the stipulation without parliamentary approval because the power of rescission vests in the Planning Minister, who can rescind the stipulations through an administrative order. Thus, the State Government has the unilateral capacity to remove the stipulation and, consequently, the stipulation is, in effect, self-imposed at the State Government level. Therefore, in preparing its whole-of-government consolidated financial statements for the year ending on 30 June 20X0, the State Government measures the parcel of land's fair value by not assuming that the restriction for use as a parking lot would definitely transfer to the market participant buyer in a hypothetical sale at the measurement date. The measurement of the asset's fair value reflects the present existence of the stipulation but also the State Government's option to rescind the stipulation. Therefore, the fair value measurement of the parcel of land by the State Government takes into account the effects of:

(a) the risk that the State Government is unable to rescind the stipulation; and

(b) the current cost (if any) of rescinding the stipulation, if it could be rescinded.

The State Government assesses that the risk of being unable to rescind the stipulation is negligible in light of not being responsible for the provision of commuter parking, the present existence of alternative parking and the fact that the land is not yet providing a service to which community members have become accustomed. In addition, the current cost of rescinding the stipulation is almost zero, because it would be effected through an administrative order.

Valuation technique

The State Government measures the fair value of the parcel of land on the basis of its highest and best use being for a shopping development, without any deduction for risk or cost of rescission. Using the market approach described in paragraphs B5 – B8 of AASB 13, the State Government measures the land's fair value at $4.0 million (after deducting the cost to a market participant buyer to convert the vacant land to a shopping development).

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In the preparation of the whole-of-government financial statements as at 30 June 20X0, a consolidation adjustment of $1.2 million is made to remeasure the fair value of the parcel of land from $2.8 million to $4.0 million.

Nature of costs included in current replacement cost

IE4 Example 3 illustrates the costs included in the replacement cost of a non-financial asset when measuring its current replacement cost, whether under the cost approach in paragraphs B8 – B9 or in accordance with paragraph Aus66.1(b).

Example 3 – Costs included in the current replacement cost of a road

A local government (Agave Council) measures its roads (including land under roads) at current replacement cost.

Year ending 30 June 20X0

As at 30 June 20X0, Agave Council controlled a new road in a new hilly housing estate to which the following costs[1] (measured using current prices[2]) relate. Agave Council assesses whether each of these costs should be included in the road's current replacement cost (before deducting obsolescence).

	Cost
	$'000
Land	12,000[3]
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	35,200

Accounting treatment

Agave Council concludes that each of these costs should be included in the road's current replacement cost, and measures the road's current replacement cost (before deducting obsolescence) as at 30 June 20X0 as $35,200,000. This is because the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility (as referred to in paragraph B9 of AASB 13) would include each of those costs, including intrinsically linked disruption costs.

Agave Council presents a single line item entitled 'roads and land under roads'. If it reported land under roads as a separate line item or within a line item entitled 'land', it would exclude the $12,000,000 land component from the measure presented for the line item entitled 'roads'.

Year ending 30 June 20X1

During the year ending 30 June 20X1, another entity's drainage works were installed under the road. Consequently, as at 30 June 20X1, if the road were replaced, it would be necessary to incur additional

[1] In this example, it is assumed that the road's construction period is short, and therefore that the issue of whether borrowing costs should be included does not arise. Paragraphs BC112 – BC116 of the Basis for Conclusions discuss views regarding whether material borrowing costs should be included in the current replacement cost of an asset.
[2] These costs are not termed 'current replacement costs' here, because doing so would imply pre-empting the analysis of the issue addressed in this example, and would therefore be circular.
[3] Consistent with paragraph Aus66.1(b) of this Exposure Draft, this land is not measured at a discount to the current price of equivalent but unrestricted land. This example does not focus on the measurement implications of any restrictions on the land's use or user pricing. Restrictions on the use of land are illustrated in Examples 1 and 2.

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current costs of $2,500,000 to make good drainage works necessarily disturbed during replacement of the road's components.

For simplicity, it is assumed that none of the replacement costs as at 30 June 20X0 (listed above) changed during the year ending 30 June 20X1.

Accounting treatment

Agave Council concludes that the current make-good cost of drainage works of another entity necessarily disturbed during replacement of the road's components ($2,500,000) should be included in the road's current replacement cost (before deducting obsolescence) as at 30 June 20X1. This is because the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility would include that make-good cost. Consequently, Agave Council measures the road's current replacement cost (before deducting obsolescence) as at 30 June 20X1 as $37,700,000 (calculated as $35,200,000 + $2,500,000).

As at 30 June 20X0, Agave Council did not anticipate the additional make-good cost of $2,500,000 to another entity's drainage works. This is because the operating environment of the road as at 30 June 20X0 did not require incurring that make-good cost if the road were replaced as at that date.

Economic obsolescence

IE5 Examples 4 and 5 illustrate when economic obsolescence of an asset held primarily for its service capacity should be identified, and how it should be measured, if the asset is measured at current replacement cost, whether under the cost approach in paragraphs B8–B9 or under paragraph Aus66.1(b).

Example 4 – Assets with temporary overcapacity

A rural town's public school has a capacity for 500 students but, because of the local demographic changes, a school for 400 students would meet current requirements. The government expects that the demand for the school's services will increase to 500 students within the next three years as a result of a planned infrastructure project.

The school is legally restricted for use as a school, and an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

Valuation of the school

In accordance with paragraph Aus66.1(b) of AASB 13, because the school's non-financial assets (composed of its land, buildings and other facilities) are held primarily for their service capacity and have a legally restricted use, and because equivalent restricted assets are not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the school's non-financial assets are measured at current replacement cost determined consistently with paragraphs B8 – B9 of AASB 13.

Economic obsolescence

Applying the principles of paragraphs B8 – B9 of AASB 13 in measuring the current replacement cost of the school's non-financial assets, the school assesses whether economic obsolescence of those assets has arisen due to a decline in the market demand for the services those assets provide. In accordance with paragraph F25 of the Australian Implementation Guidance for Not-for-Profit Entities, the apparent but temporary excess capacity of the school would not be identified as giving rise to economic obsolescence because it is only temporary. The apparent excess capacity is in fact standby capacity forming part of the service capacity of the school's non-financial assets.

Example 5 – Assets with overcapacity that is highly unlikely to reverse

In this example, the facts of Example 4 apply, except that, due to demographic changes, a school for 100 students would meet current and reasonably foreseeable requirements (including a buffer for any underestimated student demand). There is only an insignificant chance that this reduction in needed capacity will reverse within the foreseeable future.

At the school's reporting date (30 June 20X0), the gross replacement cost of the school if its capacity for 500 students were replaced would be $16 million, composed of $10 million for the buildings and other facilities and $6 million for the land (for which the replacement cost equals its estimated market value). If a

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school for 100 students were to be built at the reporting date, the replacement cost of the building and other facilities would be $4.0 million and the replacement cost of the land would be $2.7 million[4].

The State Government has not made a formal decision to reduce the school's physical capacity.

Valuation of the school

For the same reasons as in Example 4, the school's non-financial assets are measured at current replacement cost.

Economic obsolescence

In measuring the current replacement cost of the school's non-financial assets, the school assesses whether economic obsolescence of those assets has arisen due to a decline in the market demand for the services those assets provide. The decline in the market demand for this school's services is an indicator of economic obsolescence because there is only an insignificant chance that the reduction in needed capacity (from 500 students to 100 students) will reverse within the foreseeable future. Therefore, in accordance with paragraphs F24 – F25 of the Appendix F *Australian Implementation Guidance for Not-for-Profit Entities*, and despite the State Government not having made a formal decision to reduce the school's physical capacity, the current replacement cost of the school should assume replacement of a school catering for 100 students to reflect economic obsolescence, subject to the impact of any alternative community uses that affect the school's capacity that would presently be replaced (see below).

Consideration of alternative uses

In measuring the school's economic obsolescence, consideration is given to whether some or all of the school's land, buildings and equipment that are surplus from a schooling perspective might have alternative community uses, reducing the amount of economic obsolescence that would otherwise be identified. Specifically, consideration is given to whether surplus capacity from a schooling perspective could be used for State Government-provided sporting and social services, namely, martial arts classes and computing classes.

The school concludes that alternative community uses of the school's surplus capacity for schooling would not affect the amount of the school's capacity that would be replaced in a hypothetical replacement transaction (ie if the school were deprived of its facilities, which is the assumption underpinning an assessment of the amount that a market participant buyer would be prepared to pay for the school). A decision to use the school's existing surplus capacity for other services or activities, now that the school already exists, does not necessarily indicate that those alternative uses warrant constructing additional capacity specifically for those activities upon replacement of the school. In the circumstances of this particular school, it is concluded that it would be more economical to hire less expensive premises to conduct those alternative activities than to construct surplus capacity from a schooling perspective. Therefore, the amount of the school's capacity that would be replaced upon deprival is limited to the amount needed for school student tuition.

Based on these conclusions, the school's current replacement cost as at 30 June 20X0 is estimated as $6.7 million ($4.0 million building/other facilities + $2.7 million land).

Right-of-use assets under concessionary leases

IE6 Examples 6 and 10 illustrate how to measure the value of a right-of-use asset held primarily to provide services under a concessionary lease. Examples 6 and 8A illustrate how to measure right-of-use assets that are not legally restricted in the uses to which they may be put and the prices that may be charged for using them.

IE7 Example 7 illustrates how to measure a right-of-use asset:

(a) that is legally restricted in the uses to which it may be put and the prices that may be charged for using it; and

(b) for which an equivalent restricted right-of-use asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence (which would impound the discount resulting from the restriction).

<u>Explanation of changes made to the Nov 19 version</u>

Staff have removed the previous draft example on ROU assets (the mini-van example) and added 5 new examples to reflect Board's instructions to staff.

The Board instructed staff to:

1. Convert some of the previous ROU assets guidance in the Basis of Conclusions into examples;
2. Consider whether there might be situations where the fair value of the underlying asset would be similar to the fair value of the ROU asset and
3. Consider adding additional examples to address common types of lease in the NFP sector.

[4] The gross replacement cost of a school catering for 100 students exceeds one-fifth of the gross replacement cost of a school catering for 500 students. That is, a linear relationship between expected student enrolments and economic obsolescence does not exist because, to some extent, facilities will be needed regardless of the school's number of enrolments—for example, the administration office, cafeteria, and one or more toilet blocks, gymnasiums and car parks.

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IE8 Examples 8B and 8C illustrate how to measure right-of-use assets:

(a) that are legally restricted in the uses to which they may be put; and

(b) for which an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

IE9 Examples 9 and 10 illustrate considerations in assessing whether the fair value of a right-of-use asset under a concessionary lease can be measured reliably.

Example 6 – Unrestricted right-of-use asset

On 30 June 20X0, Uplift Charity receives an asset in the form of a fully donated right to use office space as a lessee under a two-year non-cancellable concessionary lease provided by a lessor with temporarily surplus office space. The lease permits Uplift Charity to use the office space for any purpose it sees fit (for example, it allows the space to be sub-leased). Uplift Charity uses the leased office space to conduct its administration of its charitable activities.

The office space is in a central business district of a major city, and the monthly market rental for the space (based on market comparison) is estimated at $100,000. If Uplift Charity had not been provided the right-of-use asset in a concessionary lease, it would have rented office space in an inner suburb at a monthly market rate of $50,000 because it lacks the financial resources to pay a commercial rental for central business district office space.

The current discount rate typical for leases of office space for 2 years is 4.5 per cent per annum.

Uplift Charity assesses how to measure the value of its right-of-use asset under its concessionary lease of the office space.

Valuation of the right-of-use asset

Uplift Charity's right-of-use asset under its concessionary lease is held primarily for its service capacity. Because Uplift Charity's right-of-use asset is unrestricted, it is measured in accordance with paragraphs 61 – 66 of the Standard. An equivalent right-of-use asset to that of Uplift Charity's right-of-use asset is obtainable in the marketplace at the measurement date (30 June 20X0) for a price supported by observable market evidence. Accordingly, Uplift Charity's right-of-use asset is measured at the market's valuation of the present value of its lease rentals, estimated by reference to market rentals in its central business district location.

Consistent with the principles in paragraph F26, the fair value of the right-of-use asset would not be based on an alternative location such as a nearby inner suburb.

The fact that Uplift Charity lacks the financial resources to pay a commercial rental for central business district office space does not affect the measurement of the fair value of its right-of-use asset under the concessionary lease. A lesser amount that Uplift Charity is willing to pay for office space is a characteristic of that entity, and not of the value to market participants of the asset it presently holds.

Uplift Charity measures the fair value of its right-of-use asset as at 30 June 20X0 as 2 years × 12 monthly payments of $100,000 discounted at a rate of 4.5% per annum, ie the present value of $2,400,000—which is $2,291,066.

Example 7 – Restricted right-of-use asset that can be acquired in the marketplace with that restriction (easement example)

On 30 June 20X0, Harmony Community Centre receives an asset in the form of a right to use an inner suburban property (house and land) as a drop-in centre primarily for students at a nearby university. That right of use asset is obtained as a lessee under a five-year non-cancellable concessionary lease provided by a local government supporting initiatives that promote mental health. The leased property is subject to an easement enabling access to an underwater stormwater pipe, which prohibits building on part of the property. The easement is a legal restriction on the use of part of the property. The easement reduces the market rentals and fair value of the property by 15 per cent. There are no other restrictions on Harmony Community Centre's use of the property. For example, it could sub-lease the property for a commercial rental, which it might choose to do if it leased a nearby property because it is in better condition or configured more usefully for its service-delivery purposes.

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A number of adjacent and nearby properties are also subject to the same easement affecting a similar proportion of the property.

The current market rate of lease rentals for leases of those adjacent and nearby properties with the same easement is $8,500 per month. (For simplicity, it is assumed that market rentals are expected to remain unchanged for the five-year duration of Harmony Community Centre's lease.) The current market discount rate for similar properties is 5 per cent per annum.

Harmony Community Centre assesses how to measure the fair value of its right-of-use asset under its concessionary lease.

Valuation of the right-of-use asset

Harmony Community Centre's right-of-use asset under its concessionary lease is held primarily for its service capacity. Equivalent (adjacent and nearby) restricted properties to the property underlying Harmony Community Centre's right-of-use asset under its concessionary lease are obtainable in the marketplace at the measurement date (30 June 20X0) for a price supported by observable market evidence. The market lease rentals for the equivalent properties (which enable estimation of the market rentals of Harmony Community Centre's right-of-use asset under its concessionary lease) incorporate the effect of the restriction-in-common (ie the easement), which would transfer to any market participant buyer of that right-of-use asset. Therefore, in accordance with paragraphs Aus66.1(a) and F6(c)(i), Harmony Community Centre's right-of-use asset is measured at fair value based on the available market evidence (market rentals) for the adjacent and nearby properties.

Harmony Community Centre measures the fair value of its right-of-use asset as at 30 June 20X1 as 5 years × 12 monthly payments of $8,500 discounted at a rate of 5% per annum, ie the present value of $510,000—which is $450,421.

In this instance, the fact that Harmony Community Centre's right-of-use asset under its concessionary lease is held primarily for its service capacity (ie not primarily for its ability to generate net cash inflows) does not affect the method of measuring the asset's fair value. In addition, because equivalent restricted assets to the property underlying Harmony Community Centre's right-of-use asset are available in the marketplace, the 15 per cent market discount resulting from the easement does not need to be estimated—it is incorporated in the observable market rentals.

Example 8A –Right-of-use asset under a whole-of-life unrestricted lease for which observable market evidence exists of a comparable asset

Under a new health initiative, a State Government agency constructs an infant health clinic and, on 30 June 20X0, grants a right to use that clinic for its entire thirty-year estimated economic life to Dawson Local Government as the lessee under a non-cancellable concessionary lease. The State Government agency retains ownership of the clinic because it lacks the legal authority to sell the property. Because Dawson Local Government provides infant health services without charge as a matter of course, the State Government agency lessor did not formally impose any restrictions over the use of the clinic or the prices that may be charged for using it.

There is observable evidence of market rentals for similar right-of-use assets within the same district as the infant health clinic, under a twenty five-year non-concessionary lease entered into by an adjoining local government (Mawson Local Government) before the new health initiative. As at 30 June 20X0, the current market rate of lease rentals for that lease entered into by the adjoining local government (Mawson Local Government) is $7,500 per month. (For simplicity, it is assumed that market rentals are expected to remain unchanged for the duration of Dawson Local Government's lease.) Rentals for properties near Dawson Local Government's leased clinic are, on average, marginally less than the rentals for similar quality properties near Mawson Local Government's leased clinic. Accordingly, market comparison techniques indicate the current market rate of lease rentals for Dawson Local Government's clinic as at 30 June 20X0 are $7,000 per month. The current market discount rate for similar properties is 5 per cent per annum.

There is no market evidence of prices for the sale of comparable infant health clinics.

Dawson Local Government assesses how to measure the fair value of its right-of-use asset under its concessionary lease of the infant health clinic, as at the date of initial recognition of that asset (30 June 20X0).

Valuation of the right-of-use asset

Dawson Local Government's right-of-use asset under its concessionary lease is held primarily for its service capacity. Because its right-of-use asset is unrestricted, it is measured in accordance with paragraphs 61 – 66 of the Standard (as is indicated in paragraph F6(b)). Observable market evidence exists at the measurement date (30 June 20X0) to enable estimation of the fair value of Dawson Local Government's right-of-use asset, using market comparison techniques.

Therefore, in accordance with paragraphs 61 – 66 and F6(b), Dawson Local Government measures the fair value of its right-of-use asset as at 30 June 20X0 using the income approach (ie based on the present value of estimated market rentals). It calculates that amount as 30 years × 12 monthly payments of $7,000 discounted at a rate of 5% per annum, ie the present value of $2,520,000—which is $1,303,971.

Although Dawson Local Government's right-of-use asset extends for the whole of the estimated economic life of the underlying property, and the lease term of the reference asset (Mawson Local Government's right-of-use asset) is shorter, this does not present problems for estimating the fair value of Dawson Local Government's right-of-use asset because the income approach is used to estimate its fair value. That is, the estimated market rentals are extrapolated for the longer lease term of Dawson Local Government's right-of-use asset.

Example 8B – Right-of-use asset under a whole-of-life restricted lease that cannot be acquired in the marketplace with that restriction (observable evidence of comparable unrestricted asset)

The fact pattern is the same as in Example 8A, except that:

(a) the lease of the infant health clinic restricts Dawson Local Government (the lessee), or any acquirer of its right-of-use asset (eg sub-lessee), to using the clinic only to provide health services without charge; and

(b) there is no observable evidence of market rentals for similarly restricted right-of-use assets within the vicinity of the infant health clinic. However, as per Example 8A, there is observable evidence of market rentals for a similar—but unrestricted—right-of-use asset within the same district as the infant health clinic, under a long-term non-concessionary lease entered into by an adjoining local government (Mawson Local Government).

Dawson Local Government assesses how to measure the fair value of its right-of-use asset under its restricted concessionary lease of the infant health clinic, as at the date of initial recognition of that asset (30 June 20X0).

Valuation of the right-of-use asset

Dawson Local Government's right-of-use asset under its concessionary lease is held primarily for its service capacity. Because its right-of-use asset is restricted, it is measured in accordance with paragraph Aus66.1 (as is indicated in paragraph F6(c)). In applying those paragraphs, because an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, Dawson Local Government's right-of-use asset is measured at its current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset. This amount is deemed to be the fair value of the right-of-use asset.

The best indication of the current replacement cost of Dawson Local Government's right-of-use asset is observable evidence of market rentals for similar but unrestricted right-of-use assets within the same district. This evidence is the market rentals for the infant health clinic, under a long-term non-concessionary lease, entered into by adjoining Mawson Local Government, and adjusted for the difference in location using a market comparison approach (using observable inputs). The present value of those adjusted market rentals is the best estimate of the amount Dawson Local Government (or another market participant acquirer of the same service capacity) would currently be prepared to pay to replace its right-of-use asset under the restricted concessionary lease. Consequently, the current replacement cost of the right-of-use asset is measured as the present value of thirty years of lease rentals under an unrestricted lease at $7,000 per month, discounted at a current market discount rate of 5 per cent per annum.

Dawson Local Government calculates that amount as 30 years × 12 monthly payments of $7,000 discounted at a rate of 5% per annum, ie the present value of $2,520,000—which is $1,303,971.

Consequently, the fair value of Dawson Local Government's right-of-use asset is estimated as the same amount regardless of whether it is unrestricted (in Example 8A) or restricted (in Example 8B). This reflects the fact that, in both examples, the same amount is necessary to acquire the service capacity embodied in those right-of-use assets as at the measurement date.

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Example 8C – Right-of-use asset under a whole-of-life restricted lease that cannot be acquired in the marketplace with that restriction (no observable evidence of comparable asset)

The fact pattern is the same as in Example 8A, except that:

(a) the lessee of the infant health clinic is Mulga Local Government, located in inland Australia;

(b) the lease of the infant health clinic restricts Mulga Local Government, or any acquirer of its right-of-use asset (eg sub-lessee), to using the clinic only to provide health services, and precludes charging a commercial return;

(c) the infant health clinic was built in a remote area. In this instance, the value of the land is a minor component of the value of the property underlying the lease; and

(d) there is no observable evidence of market rentals for similar right-of-use assets, whether restricted or unrestricted, within the vicinity of the infant health clinic.

As in Example 8A, there is no market evidence of prices for the sale of comparable infant health clinics.

The estimated current replacement cost of the clinic as at 30 June 20X0 is $800,000, composed of the building construction cost of $750,000 and the cost to replace the land of $50,000.

Mulga Local Government assesses how to measure the fair value of its right-of-use asset under its restricted concessionary lease of the infant health clinic, as at the date of initial recognition of that asset (30 June 20X0).

Valuation of the right-of-use asset

Mulga Local Government's right-of-use asset under its concessionary lease is held primarily for its service capacity. Because its right-of-use asset is restricted, it is measured in accordance with paragraph Aus66.1 (as is indicated in paragraph F6(c)). In applying those paragraphs, because an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, Mulga Local Government's right-of-use asset is measured at its current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset. This amount is deemed to be the fair value of the right-of-use asset.

There is no observable evidence of market rentals for similar right-of-use assets, whether restricted or unrestricted, within the same district.

The remote location of Mulga Local Government's leased infant health clinic makes its right-of-use asset, in substance, highly specialised. To determine a reliable measure of the current replacement cost of that asset, it is necessary for Mulga Local Government to use the current replacement cost of the underlying asset. This approach is warranted because the lease term is materially the same as the entire estimated economic life of the underlying clinic, and the clinic has no alternative use—therefore, ownership of the clinic would be unlikely to convey additional valuable rights to the lessee's right to use the clinic.

Therefore, Mulga Local Government estimates the current replacement cost (as a measure deemed to be the fair value) of the right-of-use asset arising from the lease of the infant health clinic as $800,000 at 30 June 20X0.

Note: If the lease term for Mulga Local Government's right-of-use asset were ten years, under the fact pattern presented, the current replacement cost (deemed to be the fair value) of the right-of-use asset could be measured as the value of the services consumed during that first ten-year period of the clinic's useful life (which would be equivalent to the estimated cumulative obsolescence of the asset for that ten-year period). If the pattern of consumption of the right-of-use asset were to decline over time, the estimated cumulative obsolescence might, for example, amount to 50% of the value of the underlying asset, ie be estimated as $400,000.

Example 9 – Reliable measurement of the fair value of a right-of-use asset under a restricted lease that cannot be acquired in the marketplace with that restriction: surf club building

On 30 June 20X0, Shorebreak Surf Lifesaving Club (Shorebreak), a not-for-profit entity, acquired a right-of-use asset under a non-cancellable ninety-nine year concessionary lease of the surf club building. Maritime Local Government is the lessor.

The surf club building is sited on land zoned as foreshore parkland. The lease stipulates that the surf club building is to be used for surf club activities but permits Shorebreak to operate a refreshment shop from the surf club building to subsidise the costs of running the surf club. Shorebreak has chosen not to operate a shop at this stage.

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At the nearest other beach, with similar popularity, the surf club operates a refreshment shop. As at 30 June 20X0, the fair value of that shop was estimated as $125,000.

On 30 June 20X0, the market price of a parcel of vacant land similar in size to the land under the surf club building and backing onto the beach is $550,000. The current replacement cost of the surf club building, in its present condition, was $270,000.

Shorebreak assesses how to measure the fair value of its right-of-use asset under its concessionary lease at the date of inception of the lease (30 June 20X0).

Valuation techniques

Shorebreak would measure its right-of-use asset under the concessionary lease of the surf club building at current replacement cost of the right of use asset, which is deemed to be the fair value of that asset, in accordance with paragraph Aus66.1(b). This is because the right-of-use asset is held primarily for its service capacity and because another surf club building restricted for use as a surf club in a suitable location and with similar characteristics is not available for lease in the marketplace. In accordance with paragraph Aus66.1(b), the current replacement cost of the restricted right-of-use asset under the concessionary lease should not be measured at a discount to the current price of a right-of-use asset under a lease of suitable unrestricted property that would be acquired in a replacement lease transaction.

The valuer of Shorebreak's right-of-use asset concludes that the fair value of a ninety-nine year lease of the adjacent parcel of vacant land would be materially the same as the market price to acquire ownership of that parcel of land. Therefore, the valuer concludes that the current replacement cost (as a deemed measure of fair value) of the land component underlying the right-of-use asset is $550,000. The current replacement cost of Shorebreak's right-of-use asset at the date of inception of the lease is estimated as $820,000 (ie $550,000 + $270,000). This amount represents the best estimate of the amount Shorebreak (or another market participant buyer) would currently be prepared to pay to replace its right-of-use asset under the restricted concessionary lease.

The current replacement cost of the restricted right-of-use asset arising from Shorebreak's concessionary lease is not measured by reference to the fair value of the refreshment shop at the nearest other beach ($125,000). That amount represents an indication of the surf club building's ability to generate net cash inflows. Even if Shorebreak operated a refreshment shop from the surf club building, the answer would be the same: the surf club building's ability to generate net cash inflows does not faithfully represent the amount at which a market participant buyer would price Shorebreak's right-of-use asset in relation to the surf club building. Shorebreak's concessionary lease is held primarily for its service capacity, the current value of which is not limited to its ability to generate net cash inflows.

Example 10 – Reliable measurement of the fair value of a right-of-use asset under an unrestricted concessionary lease: research facility

Public Minded Solutions is a not-for-profit research entity lessee of laboratory space under a two-year non-cancellable concessionary lease for which Health Hub Limited is the lessor. Public Minded Solutions is funded by donations and conducts the research for benevolent purposes. Any successful research findings will be transferred without charge to the State Government Health Department, rather than being commercially exploited by Public Minded Solutions. No restrictions are imposed on how Public Minded Solutions uses its right-of-use asset under the concessionary lease.

Public Minded Solutions assesses how to measure the fair value of its right-of-use asset under its concessionary lease at the at the date of inception of the lease. It also considers whether the fair value of that right-of-use asset can be measured reliably as at that date. In this regard, it addresses comments that the value of its right-of-use asset ultimately depends on the highly uncertain value that using the laboratory space to conduct research will generate.

Health Hub Limited leases out similar laboratory space at commercial rates to for-profit research bodies. Based on these two-year commercial leases, the market value of their lessees' similar right-of-use assets (at the date of inception of Public Minded Solutions' concessionary lease) is $120,000. Health Hub Limited enters the concessionary lease with Public Minded Solutions explicitly for philanthropic purposes.

Valuation techniques

Public Minded Solutions' right-of-use asset under its concessionary lease is held primarily for its service capacity. Because its right-of-use asset is unrestricted, it is measured in accordance with paragraphs 61 – 66 of the Standard (as is indicated in paragraph F6(b) of the Australian Implementation Guidance for Not-for-Profit Entities). The commercial leases entered into by Health Hub Limited provide observable market evidence enabling reliable estimation of the fair value of Public Minded Solutions' right-of-use asset under

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its concessionary lease. Consequently, the fair value of Public Minded Solutions' right-of-use asset is estimated as $120,000.

The ability to measure reliably the fair value of a right-of-use asset (an input to a process) is different from the entity's ability to measure the value of the services or other outputs that the asset will produce, which are produced by using the right-of-use asset in combination with other resources such as employee services, consumable supplies and intangible assets (eg intellectual property). Consequently, the fair value of Public Minded Solutions' right-of-use asset is not determined by estimating the highly uncertain value that using the laboratory space will generate. Instead, the value of the space as an input (ie a resource) depends on how market participant buyers price that space in its highest and best use.

Composite assets

IE10 Example 11 illustrates how to measure the value of fair values of the components of composite assets and how to classify those component assets for disclosure purposes. A composite asset is a group of functionally related non-financial assets measured at fair value, where different component assets are subject to different legal restrictions on their use or the prices that may be charged for using them.

Example 11 – Composite assets: measurement and disclosure of components

Sunnyside Charity (Sunnyside) operates an aged care facility, which is held primarily for its service capacity. The facility is composed of the following assets:

(a) owned land, no part of which is surplus to the requirements for continuing use of the facility (ie it could not be sold separately);

(b) buildings; and

(c) fixtures and fittings.

Ten percent of the land is subject to an easement enabling access to an underground stormwater pipe, which prohibits building on part of the property. The easement is a legal restriction on the use of part of the property. At the measurement date (30 June 20X0), adjacent properties are subject to the same easement, which reduces their observable market prices by 10 per cent. Based on a market comparison approach, it is concluded that land with the same easement and dimensions is obtainable in the marketplace for a price supported by observable market evidence ($4,500,000). There are no other legal restrictions explicitly applying to the land's use or the prices that may be charged for using the land.

Acquisition of the buildings, fixtures and fittings (improvements) was partially government-funded. Accordingly, the government imposes a legal restriction on the continued use of the buildings, fixtures and fittings for aged care services and specifies a cap on the prices that may be charged for using those improvements. Those restrictions on the use and pricing of the improvements would transfer to any market participant buyer of the improvements. There is a lack of market activity in the sale of equivalent restricted improvements.

The current replacement costs of the buildings, and fixtures and fittings, without a discount for any effect of the restrictions over their use and pricing, are $3,750,000 and $230,000, respectively.

Sunnyside assesses how to measure the fair values of the components of its aged care facility as at 30 June 20X0, and how to classify those component assets for disclosure purposes.

<u>**Valuation of the component assets**</u>

All components of Sunnyside's aged care facility are held primarily for their service capacity. In addition, because all components of the aged care facility are subject to legal restrictions, they are measured in accordance with paragraph Aus66.1 (as is indicated in paragraph F6(c) of the Australian Implementation Guidance for Not-for-Profit Entities).

Adjacent restricted properties to the land underlying the aged care facility are obtainable in the marketplace at the measurement date (30 June 20X0) for a price supported by observable market evidence. Those properties incorporate the effect of the restriction-in-common (ie the easement), which would transfer to any market participant buyer of that land. Therefore, in accordance with paragraphs Aus66.1(a) and F6(c)(i), the fair value of the land component of the aged care centre is based on the available market evidence of the prices for the adjacent properties.

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However, the restrictions on the building and fixtures and fittings (improvements) also apply, in effect, to the land underlying those improvements because their uses are inextricably linked. If equivalent land restricted for use as an aged care facility was obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the resulting discount (ie the discount additional to that arising from the easement) would also the deducted in measuring the land's fair value, in accordance with paragraph Aus66.1(b). Because such land is not available, the land in Sunnyside's aged care facility is measured at its current replacement cost without a discount to the $4,500,000 value of an equivalent asset that is not restricted for use in an aged care facility. Therefore, in accordance with paragraph Aus66.1(b), the current replacement cost of $4,500,000 (which incorporates the 10 per cent discount pertaining to the easement on land available in the marketplace for that observable price) is deemed to be the fair value of the land.

Because the improvements are restricted, and equivalent restricted improvements are not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, Sunnyside measures those improvements, in accordance with paragraph Aus66.1(b), at their current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset. Those amounts are deemed to be the fair values of the improvements.

Consequently, the fair value of the aged care facility as at 30 June 20X0 is measured as $8,480,000 (which is comprised of $4,500,000 + $3,750,000 + $230,000).

Classification of the facility's components for disclosure purposes

For the reasons given above, Sunnyside measures the improvements on the land of the aged care facility, in accordance with paragraph Aus66.1(b), at their current replacement cost without a discount to the current market buying price of an equivalent but unrestricted asset. Those amounts are deemed to be the fair values of the improvements.

In addition, as noted above, the restrictions on the improvements also apply, in effect, to the land underlying those improvements because their uses are inextricably linked. Therefore, Sunnyside measures the land of the aged care facility, in accordance with paragraph Aus66.1(b), at its current replacement cost without a discount to the $4,500,000 value of an equivalent asset that is not restricted for use in an aged care facility. Therefore, that current replacement cost of $4,500,000 is deemed to be the fair value of the land.

Consequently, in accordance with paragraph Aus92.1, the fair value of the entire facility ($8,480,000) would be disclosed as an amount "deemed to be fair value" [ie in accordance with paragraph Aus66.1(b)], and disclosed separately from other assets measured at fair value in accordance with paragraphs 61-66 or Aus66.1(a).

Questions to the Board

Q8: Do Board members agree with Examples 6–10 illustrating the fair value measurement of ROU assets arising for NFP entity lessees under concessionary leases?

Q9: Do Board members agree with Example 11 illustrating the fair value measurement and disclosure of composite asset?

Q10: Do Board members have any other comments regarding Examples 1-5?

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 2020-X Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Entities Held Primarily for their Service Capacity.

Commented [PA1]: **Note: To assist Board member' review, key changes made to the Basis for Conclusions since the Nov 2019 version have been marked-up in track changes.**

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 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 WoG and GGS to elect an accounting treatment that aligns with GFS principles and requirements where an accounting standard permits a choice (AASB 1049 paragraph 13). As GFS requires assets and liabilities to be measured at current market value, this has resulted in WoG and GGS electing the revaluation model as their accounting policy and measure their non-financial assets, such as property, plant and equipment, at fair value.

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

~~BC2~~ Diversity and inconsistency in applying the requirements in AASB 13

~~BC3~~BC4 The Board initially considered the application of AASB 13 *Fair Value Measurement* 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.

~~BC4~~BC5 At its December 2014 meeting, the Board considered feedback from constituents 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 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 cash inflows, and relief from disclosure of quantitative and qualitative information about the significant unobservable inputs 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*.

~~BC5~~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 constituents in the public sector requested the Board to provide guidance clarifying how the requirements in AASB 13 would be applied to the fair value measurement of public sector entity assets.

~~BC6~~BC7 Many constituents in the public sector commented that applying AASB 13 has been challenging and costly and would like guidance on how to measure the fair value of non-financial assets of public sector entities, in particular (but not limited to):

Explanation of changes made to Nov 2019 version

Main changes to the Basis for Conclusions since the Nov 2019 version are:

1. Included the Conceptual Framework's discussion of the role of service potential embodied in assets held by NFP entities, and the importance of measuring such assets at amounts faithfully representing their service potential.
2. Elaborated the reasons for undertaking the Fair Value Measurement for Public Sector Entities Project
3. Documented other options considered by the Board in address the issue of inconsistent application of AASB 13 in the NFP public sector.
4. Included discussions regarding
   - concessionary ROU assets;
   - composite assets;
   - transition requirements.

- valuation techniques to use for a public sector entity asset where there are few or no market participants (other than the entity) and where information about the inputs to a current replacement cost model may be scarce;
- the concept of obsolescence under the cost approach;
- how government-imposed restrictions on non-financial assets should be accounted for; and
- how to measure the fair value of public sector entity assets using the cost approach.

BC8 The Board noted that the measurement issues seem to be widespread across the not-for-profit public sector and involve divergence in practice. One of the major inconsistencies is how the principles in AASB 13 have been applied in measuring the fair value of a non-financial asset held primarily for its service capacity, which is also subject to legal restrictions on its use and on the prices that a not-for-profit entity may charge others for using the asset. In particular, it seems that many public sector entities measure the fair value of land that has been restricted in use (eg to build a hospital on it and not to be sold) at a discount to the market value of adjoining unrestricted land, while the building on the land (eg hospital building) is measured at current replacement cost. This means that component assets of a composite asset (eg hospital) are being measured using different assumptions and approaches, resulting in some land in these composite assets being measured at a very low values and not reflecting their service potential. It is also unclear how the discount factor was computed or the assumptions made in coming up with the discount, specifically it is unclear how much of the discount was attributable to the restriction on the usage of the asset and how much was attributable to the restriction on the prices that may be charged for using the asset.

Inconsistent with the Conceptual Framework and misrepresentation of public sector assets

BC9 The Board is of the view that an asset of a not-for-profit entity not held primarily to generate cash inflows, provides service potential to the entity by having the capacity to satisfy the wants and needs of members of the community (beneficiaries) without necessarily receiving cash in exchange from those beneficiaries. Consistent with paragraphs Aus49.1, Aus54.1 and Aus54.2 of the AASB's Conceptual Framework, the AASB considers that those assets should be measured at amounts faithfully representing their service potential (i.e. measured at their service capacity). By lowering the value of a restricted non-financial asset because it has restrictions on the price that can be charged for using it, which would diminish the net cash inflows the asset can generate directly (but the asset's service potential is unaffected) would not be consistent with the principles of the Conceptual Framework.

BC10 As mentioned in paragraph BC4, the Board was of the view that IFRS 13 had sufficient guidance and that the fair value of restricted land and restricted improvements would be measured at current replacement cost to reflect the service capacity of these assets. Measuring these type of non-financial assets using the market approach or income approach, which only reflects the price a for-profit market participant might be willing to pay, does not reflect the asset's service capacity.

BC11 There is a concern that significant non-financial assets with ongoing service capacity might be written off due to restrictions imposed on the use of the asset and/or on the prices that can be charged for using the asset. There is a risk that users of public sector financial statements would not get a true representation of the financial position of public sector entities from the financial statements. In particular, users would not be able to understand from the financial statements the assets being managed by the public sector entity and whether such assets have remaining service capacity. It would also be difficult for users to understand the costs required to replace the service capacity, which would make intergenerational equity difficult.

BC12 The Board also considers that applying different measurement methods in measuring assets that are subject to the same restrictions as the land would also conflict with the Framework's qualitative characteristic of comparability (because it would apply inconsistent accounting treatments to similar items).

Different approaches used in other jurisdictions

BC13 The Board observed that there appeared to be significant difference in how public sector entities in New Zealand measure the fair value of non-financial assets that are held primarily for their service capacity compared to the public sector entities in Australia. It seemed that a discount might be applied to reflect restrictions imposed on the use of the asset, but a discount is not applied to reflect restrictions in charging a price for use of the asset or on the restriction to sell the asset in some jurisdictions. This appeared to be different to the current practice in Australian public sector entities.

~~BC7~~BC14 Having considered the widespread divergence issues in applying AASB 13 in the not-for profit public sector, the Board decided to undertake the *Fair Value Measurement for Public Sector Entities Project* (the Project) to address the interpretative issues regarding applying the requirements of AASB 13 to non-financial assets of not-for-profit public sector entities measured at fair value.

BC15 In addition, in consideration of its Service Concession Arrangements: Grantors project, the Board decided at its February 2016 meeting that because a service concession asset is a specialised asset that the grantor uses for its service potential to achieve public service objectives, 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 public sector 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 Public Sector Entities Project.

Consistent with the Board's strategy

~~BC8~~

~~BC9~~

~~BC10~~BC16 The Board's strategy for the period 2017-2021 identifies seven strategic objectives. The Project is consistent with the following strategic objectives:

- strategic objective 1 'Develop, issue and maintain principles-based, Australian accounting and reporting standards and guidance that meet the needs of external report users (including financial reports) and are capable of being assured and enforced. For 'publicly accountable' entities maintain IFRS compliance; for others, use IFRS Standards (where they exist), and transaction neutrality (modified as necessary), or develop Australian-specific standards and guidance.' The Project recognises that modifications in the form of amendments or further guidance may be necessary to AASB 13 in response to user feedback to clarify the application of AASB 13 in measuring the fair value of assets held by not-for-profit public sector entities; and
- strategic objective 4 'Attain significant levels of key stakeholder engagement, through collaboration, partnership and outreach.' Undertaking the Project, and the consultative manner in which the Project has been conducted (see paragraphs BC17–BC18) show that the Board seeks and responds to stakeholder feedback; thereby providing support to the Board's strategy of encouraging active stakeholder participation.

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

~~BC11~~BC17 The AASB established the Fair Value Measurement Project Advisory Panel (the Panel) to provide a forum for the AASB to consult on specific fair value measurement issues. The Panel consists of industry experts that have experience in dealing with fair value measurement issues, and includes asset valuers and financial statement preparers and auditors. The AASB has held several meetings with the Panel ~~: 6 November 2017, 16 May 201810 April 2019~~over the course of the project. The Project has been assisted considerably by extensive background research performed by two Panel members. Some of that work is reflected in this Exposure Draft as well as Board agenda papers.

BC18 As part of the Project, the AASB has also consulted asset valuers from some accounting firms 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.

Extending the Project's scope to address fair value measurement of right-of-use assets arising under concessionary leases

~~BC12~~BC19 Additionally, the Board received feedback from some not-for-profit entities in both the private sector and public sector that they are encountering difficulties in applying the principles of AASB 13 in determining the fair value of right-of-use assets arising as lessees under concessionary leases, particularly if restrictions are imposed on the use of the underlying leased asset. Concessionary leases in this context are leases with significantly below-market terms and conditions principally to enable the entity to further its objectives, as referred to in AASB 16 *Leases* and AASB 1058 *Income of Not-for-Profit Entities*.

~~BC13~~BC20 The Board considered the prevalence and magnitude of concessionary leases in the not-for-profit sector, and the significance of restrictions on rights of use of the underlying leased assets in many cases, and decided to extend the scope of the Project to address the interpretative issues regarding the fair value measurement of right-of-use assets arising under concessionary leases.

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~~BC14~~BC21 AASB 16 and AASB 1058 are effective for annual reporting periods beginning on or after 1 January 2019; therefore, not-for-profit entities were originally required to measure right-of-use assets arising under concessionary leases at fair value at initial recognition from this date. Having considered the feedback received, the Board issued two amending Standards to provide a temporary option for not-for-profit entities not to measure right-of-use assets arising under concessionary leases at fair value. They are AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* and AASB 2019-8 *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases*. The Board will reassess the temporary relief after it finalises guidance to assist not-for-profit entities in measuring the fair value of right-of-use assets and the financial reporting framework for private sector not-for-profit entities has been finalised.

Extending the Project's scope to also apply to private sector not-for-profit entities

~~BC15~~ Although the Project was initiated to address issues raised in respect of fair value measurement of non-financial assets held by public sector not-for-profit entities, the Board formed the view that the principles it is proposing are also appropriate for not-for-profit entities in the private sector. A prime example of this is the set of proposed principles for measuring the fair value of not-for-profit entity lessees' right-of-use assets under concessionary leases. Consequently, the proposals in this Exposure Draft would also be applicable to not-for-profit entities in the private sector.

~~BC16~~BC22

Reasons for developing the Exposure Draft

~~BC17~~BC23 Because IFRS 13 (and, therefore, AASB 13) is generally expressed from the perspective of for-profit entities in the private sector, there is a need for sector-specific guidance to assist not-for-profit entities in addressing the issues they encounter in measuring the fair value of their non-financial assets, particularly assets held primarily for their service capacity and therefore not primarily for their ability to generate net cash inflows. During the course of its project, the Board formed the view that, although the issues were raised primarily in respect of not-for-profit entities in the public sector, the principles it is proposing are also appropriate for not-for-profit entities in the private sector. A prime example of this is the set of proposed principles for measuring the fair value of not-for-profit entity lessees' right-of-use assets under concessionary leases (see paragraph BC24(e)).

~~BC18~~BC24 After considering input from the Panel, the Board decided to propose amendments to Australian Accounting Standards (principally AASB 13) and illustrative guidance to assist the application of the following principles:

(a) highest and best use (paragraphs 27–30), including consideration of the physical characteristics of an asset and legal restrictions imposed on the use of an asset or the prices that may be charged for using an asset;

(b) when to measure a non-financial asset at current replacement cost;

(c) how to measure the current replacement cost of a non-financial asset, including the nature of component costs to include in that amount, consideration of borrowing costs and other finance costs, the trigger for economic obsolescence, and whether the current replacement cost of the land component of real property held primarily for its service capacity should always be measured in the land's present location;

(d) how to measure the fair values of the components of composite assets; and

(e) how to measure the fair value of not-for-profit entity lessees' right-of-use assets on initial recognition, in respect of leases with significantly below-market terms and conditions principally to enable the entity to further its objectives ('concessionary leases') in accordance with AASB 1058 *Income of Not-for-Profit Entities*, particularly in respect of restrictions affecting such right-of-use assets and the specialised nature of many assets underlying the leases. Guidance was also developed on measuring such right-of-use assets at current replacement cost.

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Service capacity and service potential

BC25 The Board observed while colloquially the terms 'service capacity' and 'service potential' are sometimes used interchangeably, there are some differences between how the terms 'service capacity' and 'service potential' are used in accounting literature. In AASB's Conceptual Framework paragraph Aus49.1[5] 'service potential' has been used to refer to an attribute or quality of assets, but not the quantum of assets. Whereas, in AASB 13 and AASB 136 *Impairment of Assets* the phrase 'service capacity', not 'service potential', is used when describing either the measurement or quantum of not-for-profit entities' assets or the purpose for holding assets that warrant not-for-profit modification of measurement requirements. Paragraph B8 of AASB 13 states that: "The cost approach reflects the amount that would be required currently to replace the **service capacity** of an asset (often referred to as current replacement cost)" [bolding added].

BC26 Since majority of the proposals in this Exposure Draft are related to the measurement of particular assets at their current replacement cost, the Board decided that the title of the Exposure Draft should refer to 'service capacity' to be consistent with the terminology in paragraph B8 of AASB 13.

Addressing the measurement of non-financial assets held primarily for their service capacity (paragraphs Aus66.1 and F3–F14)

BC27 Many non-financial assets of not-for-profit entities are held primarily for their service capacity, and some of those assets have legal restrictions imposed on their use or the prices that can be charged for using them. Constituents ~~have~~ asked the Board to clarify how to apply the principle in paragraph 28(b) of AASB 13 that the highest and best use of a non-financial asset takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property). Paragraph IE29 of the Illustrative Examples accompanying IFRS 13 indicates that legal restrictions on the use of an asset that would not transfer to market participant buyers of the asset would not be taken into account in the asset's fair value measurement; however, the reverse is not always true. Legal restrictions on the use of an asset affect the identification of the highest and best use of the asset—and therefore its fair value—*if, and only if, market participants would take those legal restrictions into account when pricing the asset*. The Board has been informed that uncertainty and diverse interpretation have arisen regarding how to identify whether particular legal restrictions transferable to market participant buyers would affect pricing decisions made by those buyers. The Board addressed this issue in developing the measurement proposals in this Exposure Draft. Paragraphs BC28 – BC32 discuss first the boundary and key objective of those measurement proposals.

Boundary and key objective of the proposed requirements – non-financial assets held primarily for their service capacity

BC28 The Board's measurement proposals are delineated as applying to non-financial assets held primarily for their service capacity, because the fact that these assets are not held primarily for their ability to generate net cash inflows is the key reason why it is unclear whether their fair value should be measured using the market approach or income approach where the resulting measures differ from the assets' current replacement cost. The Board refined the scope of its proposed requirements to those assets with a legally restricted use or that are subject to a legal restriction on the prices that may be charged for using them, because the existence of such restrictions is at the heart of the uncertainty and diverse practices.

BC29 The Board considered that, in the context of paragraph Aus66.1, a 'legal restriction' is a restriction that cannot be revoked by the not-for-profit entity holding the non-financial asset that would be transferred to any market participant buyer of the asset. A legal restriction might not necessarily arising from legislation as it could arise due to instructions from Ministers, Governments or other authorities.

BC30 For the avoidance of doubt, the Board decided to propose specifying that, if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is measured at fair value based on the available market evidence for the equivalent restricted asset (see paragraph Aus66.1(a) and paragraphs BC34–BC35). The Board does not expect the proposed requirement to result in changed practice.

BC31 The proposed measurement requirement that other restricted assets held primarily for their service capacity are to be measured at current replacement cost without a discount to the current market buying price of an

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[5] Conceptual Framework paragraph 49.1 states that "In respect of not-for-profit entities in the public or private sector, in pursuing their objectives, goods and services are provided that have the capacity to satisfy human wants and needs. Assets provide a means for entities to achieve their objectives. Future economic benefits or service potential is the essence of assets. Future economic benefits is synonymous with the notion of service potential, and is used in this Framework as a reference also to service potential. Future economic benefits can be described as the scarce capacity to provide benefits to the entities that use them, and is common to all assets irrespective of their physical or other form."

equivalent but unrestricted asset (see paragraph Aus66.1(b)) is designed to address the inconsistency issue described in paragraph BC8 and avoid not-for-profit entities measuring those assets based on their ability to generate direct cash flows rather than reflecting the assets' service capacity. Consistent with the Conceptual Framework, to faithfully represent the asset's service potential, the Board considers ~~,~~that, where an asset has restrictions that would diminish the net cash inflows the asset can generate directly~~,~~ but do not diminish the asset's service potential, it would be inappropriate to discount the asset's measurement for the effect of the restriction.

BC32 The Board observed that providing guidance on this issue arising in respect of assets held primarily for their service capacity would not have implications for for-profit entities applying AASB 13, because all assets of for-profit entities are held primarily for their ability to generate net cash inflows (whether directly or indirectly).

Equivalent restricted asset is obtainable in the marketplace

~~BC19~~BC33 Legal restrictions imposed on the use of an asset held by a not-for-profit entity, or on the prices that can be charged for using that asset, might significantly reduce the price that a for-profit entity would currently be prepared to pay for the asset (compared with otherwise-identical unrestricted assets). A for-profit entity market participant buyer would be unwilling to pay more for an asset than the amount on which it can generate a commercial rate of return. For example, if land is acquired by a local government from private sector owners and immediately thereafter becomes legally restricted for use as a cemetery, park or land under roads, that restriction would typically prevent a market participant from generating a commercial return on the price paid immediately beforehand to the private sector vendors (for the unrestricted parcel of land). Many commentators argue that, if the market approach or income approach were applied to measure the fair value of the newly restricted land, the resulting fair value measurement would be an amount significantly less than the amount paid to acquire the asset.

~~BC20~~BC34 If restricted land in a suitable location and with similar characteristics was obtainable in the marketplace (impounding the discount resulting from the restriction):

(a) no market participant buyer would be willing to pay more than the price of that restricted land. As paragraph B9 of AASB 13 states: " … 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.";

(b) the market approach and income approach would be valid candidates for estimating the fair value of the not-for-profit entity's existing restricted land under paragraphs 61 – 66 and B5 – B33 of AASB 13; and

(c) if a not-for-profit entity (eg the local government referred to in paragraph BC33) paid a higher price to acquire unrestricted land immediately before the measurement date, that price would exceed the fair value of the restricted land (ie that entity would have made an uneconomic decision to acquire unrestricted land when suitable restricted land is available for a lower price).

~~BC21~~BC35 Accordingly, the Board decided to specify in paragraph Aus66.1(a) of the proposed amendments of AASB 13 that, if a non-financial asset held primarily for its service capacity and measured at fair value:

(a) has a legally restricted use or is subject to a legal restriction on the prices that may be charged for using it; and

(b) an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence,

the asset's fair value is measured based on the available market evidence for the equivalent restricted asset. This is consistent with paragraphs 61 – 66 of AASB 13.

~~BC22~~BC36 The measurement of the fair value of the non-financial assets referred to in paragraph BC35 has not been the subject of diversity in practice.

Equivalent restricted asset is not obtainable in the marketplace

~~BC23~~BC37 The source of uncertainty and diversity in practice for restricted assets concerns those for which an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence (eg land in a suitable location and with similar characteristics to the asset being measured by a not-for-profit entity often is unobtainable in the marketplace, because such land (and the buildings and other improvements on that land) are generally held by the not-for-profit entity for continuing use of their service capacity rather than for sale). In such cases, a market participant buyer that is a not-for-profit entity could not acquire the land for an amount impounding the discount resulting from the restriction. Such an entity might have no choice but to acquire unrestricted land that subsequently becomes subject to a legal restriction.

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~~BC24~~BC38 Some not-for-profit sector constituents questioned whether the characteristics of the market participant buyer should be assumed to be similar to that of the entity holding the asset being measured at fair value under AASB 13. Accordingly, in the circumstances described in paragraph BC37, they argued it is unclear whether the market approach or income approach referred to in paragraph 62 of AASB 13 would be valid candidates for estimating the fair value of the not-for-profit entity's existing restricted land.

Inconsistency between measurement of restricted land and restricted improvements on that land

BC39 Some public sector constituents have informed the Board that many not-for-profit public sector entities have been applying different measurement methods in measuring the fair values of restricted land and improvements on that restricted land which are also subject to the same restrictions. Specifically, they measure restricted land (eg land under a hospital) using the market approach and applying a significant discount to the current price of comparable unrestricted land, while measuring the restricted improvements on the land (eg the hospital improvements) at current replacement cost.

BC40 These constituents explained that market participant buyers would not be willing to pay more for the land than the amount on which they can generate a commercial rate of return; and therefore, the restricted land should reflect the amount that a market participant buyer would be willing to pay. However, they apply a different concept when measuring the fair value of the restricted improvements on the restricted land. They argued that the service capacity of the facility (eg hospital land and improvements) is embodied by the improvements on the land, not the land; and therefore, the restricted improvements should be measured reflecting their service capacity.

BC41 The Board considered the likely impact on the statement of financial position if restricted land and restricted improvements on land were measured under the following four alternative measurement approaches, and their advantages and disadvantages, as outlined in the table below:

- Alternative 1 – Measure restricted land and improvements at discounted cash flows based on the cash proceeds the assets are expected to generate, and disregard the service capacity of the assets. This approach would reflect restrictions on both the use of the asset and restrictions on the assets' ability to directly generate cash flows;
- Alternative 2 – Measure restricted land and improvements based on an assumption that the not-for-profit entity can generate rent at a commercial rate and applying a discount to reflect only the restrictions on the use of the asset (ie not discounting for restrictions on the ability to directly generate cash flows if service capacity remains);
- Alternative 3 – Measure restricted land based on the cash proceeds it is expected to generate (like Alternative 1) and measure improvements at current replacement cost (this is the current practice in many not-for-profit public sector entities); and
- Alternative 4 – Measure restricted land and restricted improvements at current replacement cost. This alternative would reflect the service capacity of the asset in the statement of financial position and disregard the asset's ability to directly generate cash flows (ie the measurement would not be limited to the amount of direct cash flows).

	Alternative 1	**Alternative 2**	**Alternative 3**	**Alternative 4**
Impact on statement of financial position	Assets measured at scrap value.	Assets written down to reflect the restrictions on their use.	Only restricted land measured at scrap value.	Assets measured at values reflecting their service capacity.
Advantages	Achieve consistency, within and across the public and private sectors.	This alternative could achieve consistency across assets of an entity.	Likely no change to current practice.	Achieve consistency and compliant with Conceptual Framework. Cost effective in measuring fair value.

	Measuring fair value under this alternative would generally be relatively easy (except in relation to the provision of services for subsidised user charges).			
Disadvantages	Inconsistent with Conceptual Framework. Statement of financial position would not faithfully depict service capacity of restricted assets of not-for-profit entities because only very small amounts would be recognised for them.	It might be costly to obtain commercial returns information and often will be very difficult to measure the appropriate discount for the restriction on the use of the asset.	Inconsistency in accounting for assets with similar restrictions and with Conceptual Framework.	Might change current practice in various jurisdictions.

BC42 The Board considered the advantages and disadvantages of each of the alternative measurement approaches and is of the view that recognising land at heavily discounted amount (unless an equivalent restricted asset is obtainable in the marketplace for a price that incorporates that discount) would not reflect the service capacity of the land and therefore would conflict with the AASB's Conceptual Framework. The Board also considers that applying different measurement methods in measuring assets that are subject to the same restrictions as the land would also conflict with the Framework's qualitative characteristic of comparability (because it would apply inconsistent accounting treatments to similar items). Therefore, the Board is of the view that Alternative 4 would be the best approach in measuring restricted land and restricted improvements an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

Other considerations suggested by constituents

~~BC25~~BC43 From its outreach activities, ~~the Board identified~~some constituents in the not-for-profit public sector commented that AASB 13 is not clear which of the three measurement approaches in the Standard should be applied in measuring restricted land when land in a suitable location and with similar characteristics to the asset being measured is unobtainable in the marketplace. They suggested three options for modifying AASB 13 to address the uncertainty and diversity in practice when measuring such restricted land:

(a) Option 1: specify that any (or a combination) of the market, income and cost approaches may be applied to measure the restricted asset's fair value, which should be measured at a significant discount to the current price of a comparable unrestricted asset. The Board noted that this would likely lead to the same outcome as Alternative 3 in paragraph BC41;

(b) Option 2: same as Alternative 4 in paragraph BC41, specify that the restricted asset must be measured at current replacement cost, which should be measured without a discount to the current price of a comparable unrestricted asset. The resulting measurement should be deemed to be the asset's fair value—this would not necessarily achieve conformity with IFRS 13 *Fair Value Measurement*, because the market and income approaches would not be permitted (see paragraphs BC152–BC153); and

(c) Option 3: specify that both treatments under either Option 1 or Option 2 are permitted when applying AASB 13, ie provide an accounting policy choice regarding how to measure such a restricted asset.

~~BC26~~BC44 These options are discussed in paragraphs BC45 – BC68.

~~BC27~~BC45 The Board considered the advantages and disadvantages of Option 3. It noted that Option 3 has the advantages of allowing valid arguments of those holding different perspectives to be reflected in financial statements of not-for-profit entities and causing the least disruption to existing practice, thereby minimising some of the costs to preparers and auditors of financial statements of not-for-profit entities that relate to this issue. However, providing an explicit accounting policy choice would mean that costs might continue to be incurred by some parties in ongoing disagreements about which accounting policy should be selected by

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particular entities. Most importantly, providing an explicit accounting policy choice would be incompatible with the Board's function, under its *Policies and Processes*, to "facilitate the development of accounting standards that require the provision of financial information that … facilitates comparability" (paragraph 2). The Board considers that it would be futile to modify AASB 13 on the primary issue raised in this project without reducing the significant existing diversity in practice surrounding this issue.

~~BC28~~BC46 Some commentators in the not-for-profit sector have argued that, in measuring restricted land when land in a suitable location and with similar characteristics to the asset being measured is unobtainable in the marketplace, Option 1 should be adopted, ie the market approach or income approach should be applied and the restricted land's fair value should be measured at a significant discount to the current price of comparable unrestricted land. Their reasons include that:

(a) the prices for unrestricted land reflect uses of the land, and rights to charge rentals for using the land, that are not permitted under the restriction. If the restricted land's fair value were measured without a discount to the current price of comparable unrestricted land, the measurement would lack comparability because it would depict different assets as having the same value;

(b) market participant buyers would be unwilling to pay more for the land than the amount on which they can generate a commercial rate of return (this argument reflects a view that only the pricing decisions of for-profit entity market participants should be taken into account);

(c) measuring the fair value of assets[6] at amounts exceeding the net cash inflows from their permitted use discounted at a commercial rate of return would not faithfully represent the assets' contribution to the entity's solvency; and

(d) this treatment has been widely adopted in a number of jurisdictions.

~~BC29~~BC47 However, as noted in the analysis of Alternative 3 in paragraph BC41, the Board is concerned that such a measurement of the restricted land's fair value would:

(a) in effect, measure the land at its scrap value and would not represent faithfully the current market price of the land's service capacity. In addition, it would contradict the Board's conclusion, in making AASB 2016-4 *Amendments to Australian Accounting Standards – Recoverable Amount of Non-Cash-Generating Specialised Assets of Not-for-Profit Entities*, that the fair value of an asset held primarily for its service capacity (which typically is a specialised asset) is not its scrap value. The Board stated that this conclusion in AASB 2016-4 is "because an exit price reflects the sale of an asset to a market participant that has, or can obtain, the complementary assets … needed to use the specialised asset in its own operations. In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset" (Basis for Conclusions on AASB 2016-4, paragraph BC15). In the context of this Exposure Draft, a market participant buyer stepping into the shoes of a not-for-profit entity holding a non-financial asset for its service capacity is another not-for-profit entity that needs that asset to provide services to beneficiaries[7]; and

(b) if the restricted land had necessarily been acquired by purchasing unrestricted land, cause the imposition of the restriction to result in a heavy write-down of the asset's fair value. Such a write-down would represent unfaithfully that the land's service capacity has reduced significantly.

BC48 The Board considers that its concerns described in paragraph BC47 apply equally to restricted assets other than land. For example, if the fair value of restricted land were to be measured at a significant discount to the current price of comparable land for the reasons in paragraph BC46, the fair value of buildings restricted for use as public schools or public hospitals should for consistency be measured at scrap values (the Board considered this measurement approach in Alternative 1 in paragraph BC41). This would result in statements of financial position of not-for-profit entities representing unfaithfully that those entities essentially only possess financial assets.

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[6] Either on a stand-alone basis or as part of a group of interdependent assets, under the valuation premises outlined in paragraph 31 of AASB 13.

[7] Paragraphs BC78 – BC79 of the IASB's Basis for Conclusions on IFRS 13 state that: "… for specialised non-financial assets that have a significant value when used together with other non-financial assets, for example in a production process, but have little value if sold for scrap to another market participant that does not have the complementary assets, … the scrap value for an individual asset would be irrelevant because the valuation premise assumes that the asset would be used in combination with other assets … . Therefore, an exit price reflects the sale of the asset to a market participant that has, or can obtain, the complementary assets … needed to use the specialised asset in its own operations. In effect, the market participant buyer steps into the shoes of the entity that holds the specialised asset. … When a market price does not capture the characteristics of the asset … that price will not represent fair value. In such a situation, an entity will need to measure fair value using another valuation technique (such as an income approach) or the cost to replace or recreate the asset (such as a cost approach) depending on the circumstances and the information available." Although the IASB refers to the market participant buyer stepping into the shoes of an entity holding a *specialised* asset, the IASB's conclusion can logically be extended in a not-for-profit entity context to any assets (whether specialised or not) that contribute more to an entity when used together with other non-financial assets than their selling price to another market participant without the complementary assets. The market participant buyer stepping into the shoes of the not-for-profit entity holding the asset held primarily for its service capacity obtains value from that asset in the first instance by providing needed services to beneficiaries, but also obtains value through financial support [in the form of rates, taxes, grants and appropriations] and through any user charges.

~~BC30~~BC49 Therefore, the Board proposes requiring that, in respect of a non-financial asset of a not-for-profit entity that is held primarily for its service capacity (eg restricted land and restricted improvements on the restricted land):

(a) if the asset has a legally restricted use or is subject to a legal restriction on the prices that may be charged for using it; and

(b) an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence,

where another Australian Accounting Standard (eg AASB 116 *Property, Plant and Equipment*) has required the asset to be measured at fair value, the asset is to be measured at current replacement cost, applying the guidance in paragraphs B8– B9 of AASB 13: see paragraph Aus66.1 of the [draft] Standard. In applying this proposed requirement, the asset's current replacement cost would be measured without a discount to the current market buying price of an equivalent but unrestricted asset. For example, in the case of the restricted land described in paragraph BC39,

if restricted land in a suitable location and with similar characteristics was not obtainable in the marketplace, the restricted land's value should not be measured at a discount to the current price of suitable unrestricted land.

~~BC31~~BC50 For the purposes of paragraph BC49, a reference to another Australian Accounting Standard requiring an asset to be measured at fair value includes circumstances in which an entity has *elected* to apply the revaluation model for measurement after initial recognition to the asset and the other assets in the same class (eg the revaluation model in paragraph 31 of AASB 116) and, in turn, the relevant Standard requires the asset to be measured at fair value at the date of the revaluation.

~~BC32~~BC51 Other points made by the Board in response to the arguments for Option 1 in paragraph BC46 are that:

(a) with reference to argument in paragraph BC46(b) the Board is of the view that the hypothetical market participant buyer would be another not-for-profit entity with similar service delivery objectives and would be willing to pay more than the amount on which they can generate a commercial rate of return for a land or an asset it requires to fulfil its service delivery objectives.

~~(a)~~(b) with reference to the argument in paragraph BC46(c) that measuring the fair value of assets at amounts exceeding the net cash inflows from their permitted use discounted at a commercial rate of return would not faithfully represent the assets' contribution to the entity's solvency, the Board proposes requiring separate disclosure of current replacement cost measurements of restricted assets determined under proposed paragraph Aus66.1(b) as amounts 'deemed to be fair value'. Such 'fair value measurements' would be identified by the amended AASB 13 as being potentially non-compliant with IFRS 13 (see paragraph BC54). Consequently, the assets' measurements should not be misconstrued as measures of the net cash inflows from their permitted use discounted at a commercial rate of return; and

~~(b)~~(c) observes that, with reference to the implication of paragraph BC46(d) that ceasing to measure the value of restricted land at a significant discount to the current price of comparable unrestricted land would result in a widespread change to current practice, measuring the fair value of other restricted assets at a significant discount to the current price of comparable assets (eg measuring the fair value of buildings restricted for use as public schools or public hospitals at scrap values) would also be a significant change to current practice. As discussed in paragraphs BC42 and BC48, the Board considers it is essential that whichever policy is applied to measure the current value of restricted non-financial assets held by not-for-profit entities, it must be applied consistently to land and non-financial assets other than land.

~~BC33~~BC52 The Board's proposal to modify AASB 13 to specify using current replacement cost to measure the current value of non-financial assets for not-for-profit entities held primarily for their service capacity is broadly consistent with the requirement in AASB 1059 *Service Concession Arrangements: Grantors* to use current replacement cost to measure the fair value of a grantor's service concession assets (AASB 1059, paras. 7, 8, and 9(b)). This requirement reflected the AASB's view that, if the grantor in a service concession arrangement compensated the service concession operator for the service concession asset and service provision by granting the operator a right to earn third-party user tolls, the service capacity embodied in the grantor's service concession asset is unaffected by granting the operator a right to toll, because the asset provides the same utility to the public regardless of that grant. Unlike other approaches to measuring fair value, the cost approach (current replacement cost) results in the same measure of the fair value of a particular service concession asset regardless of whether the operator was granted a right to earn third party user tolls (AASB's Basis for Conclusions on AASB 1059, paragraphs BC50—BC53 and BC62—BC66). As with AASB 1059, using current replacement cost to measure particular non-financial assets may not be compliant with IFRS 13 because neither the market approach nor income approach may be used to measure the asset. If other alternative measurement approaches in paragraph BC41 or other options in paragraph BC43 were adopted, the Board would need to reassess the accounting outcome in AASB 1059 and the amendments made to AASB 136 established by AASB 2016-4.

~~BC34~~BC53 The Board's proposal to require that, in respect of not-for-profit entities, restricted assets described in paragraph BC37 are to be measured at current replacement cost would not preclude using observable market prices when they are materially the same as current replacement cost. For example, this could occur when such assets are compulsorily acquired and the compensation arrangements are based on market value principles.

~~BC35~~BC54 The Board considers that it presently is not sufficiently clear under AASB 13 how to measure the fair value of non-financial assets of a not-for-profit entity held primarily for their service capacity, particularly when such assets are subject to legal restrictions transferable to market participant buyers (ie more than one approach could be argued). Therefore, the Board's proposal to require using current replacement cost as the deemed measure of the fair value of non-financial assets of not-for-profit entities held primarily for their service capacity (except where the asset is restricted and an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence[8]) is designed to reduce uncertainty and diversity in practice in how to measure the ~~current~~ fair values of these assets. The Board observes that the proposals:

(a) would not necessarily change practice for some not-for-profit entities (other than changing the manner in which those ~~current~~ fair value measurements are presented in financial statements); and

(b) ~~does~~ do not indicate that entities changing practice in how they measure those assets made an error in applying the existing requirements of AASB 13.

Testing the boundary of the proposed requirements – whether to mandati~~ng~~e the use of current replacement cost for non-financial assets of not-for-profit entities held primarily for their ability to generate net cash inflows

~~BC36~~

~~BC37~~BC55 The Board tested the boundary for the proposed requirements referred to in paragraph BC54 firstly by considering whether current replacement cost should be mandated in respect of any non-financial assets of not-for-profit entities held primarily for their ability to generate net cash inflows, particularly if those assets are specialised and/or their uses (or the prices that may be charged for using them) are legally restricted. The Board:

(a) noted that AASB 13 already indicates, in effect, that the fair value of specialised assets held primarily for their ability to generate net cash inflows in combination with other assets is often measured under the cost approach—ie at current replacement cost as a measure of fair value (AASB 13, paragraph B9 and the IASB's Basis for Conclusions on IFRS 13, paragraphs BC78–BC79), but does not mandate using the cost approach for all specialised assets; and

(b) considered that, if a specialised asset is held primarily for its ability to generate net cash inflows on a stand-alone basis, and is subject to a legal restriction, the asset's fair value would not exceed the price a market participant buyer would be prepared to invest to generate a commercial return from the asset. (Restrictions over assets that would transfer with the assets to market participant buyers generally result in those assets being specialised.) Therefore, if sales evidence of similarly restricted assets were unavailable but market prices were observable for similar but unrestricted assets, it would be appropriate to apply a discount to the market price of the comparable asset when measuring the fair value of the restricted asset. For example, assume that:

   (i) a not-for-profit entity held a surplus building subject to heritage preservation requirements, to generate rental income and for capital appreciation;

   (ii) that entity originally acquired the building for service-delivery and administrative purposes because of its location and physical capacity: it is not required to retain the building for heritage purposes (the heritage preservation requirements simply transfer to any market participant buyer); and

   (iii) the heritage preservation requirements increased the building's maintenance costs and impeded changing the layout of its accommodation in response to tenants' needs, and therefore under either the market approach or income approach, the building's fair value is estimated to be 10 per cent less than the observable market price of an adjacent unrestricted building that is otherwise identical.

   In that example, a for-profit entity market participant buyer would be unwilling to pay more for the heritage building than the price of the adjacent building minus a 10 per cent discount. Similarly, the

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8 See paragraph Aus66.1.

not-for-profit entity would be unwilling to pay more than that discounted price for the heritage building if it hypothetically were bidding for it, and (because of the nature of the asset) another not-for-profit entity stepping into its shoes would be unwilling to pay more than that discounted price for the heritage building. It is unrealistic to expect that another market participant buyer would have a need for that specific heritage building and be willing to pay more than a for-profit entity market participant buyer if the reporting entity (ie the not-for-profit entity holding the building) is not; and

(c) noted that the issues raised regarding how to measure the fair value of specialised and/or restricted assets generally relate to assets held primarily for their service capacity.

~~BC38~~BC56 For the reasons in paragraph BC55, the Board concluded that current replacement cost, as a measure of fair value, should not be mandated for assets of not-for-profit entities held primarily for their ability to generate net cash inflows, regardless of whether they are specialised.

~~BC39~~BC57 The Board considered whether the boundary for its proposed requirement to use current replacement cost to measure the fair value of non-financial assets of not-for-profit entities held primarily for their service capacity (except where the asset is restricted and an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence) should be based on one or more of the factors to consider when selecting a measurement basis for assets, as identified by the International Public Sector Accounting Standards Board (IPSASB) in its Consultation Paper entitled *Measurement* (April 2019). Those factors identified by the IPSASB in that Consultation Paper (paragraph 1.5(b)) that are related to the nature and circumstances of the asset, and the Board's responses to them, are set out below:

(a) The asset was acquired in a non-exchange transaction – the Board concluded that this should not affect how to measure an asset's current value as at a particular date, because market conditions affecting an asset at that date are independent of how the asset was acquired;

(b) The assets are held to provide services ('non-cash-generating assets'), to generate a commercial return ('cash-generating assets') and/or for trading or sale – the Board noted that this distinction draws upon the distinction between 'cash-generating assets' and 'non-cash-generating assets' in IPSAS 26 *Impairment of Cash-Generating Assets* and IPSAS 21 *Impairment of Non-Cash-Generating Assets*.[9] IPSAS 21 defines 'cash-generating assets' as "assets held with the primary objective of generating a commercial return" and 'non-cash-generating assets' as "assets other than cash-generating assets". Under IPSAS 21, the value in use of a non-cash-generating asset is measured by reference to the asset's replacement cost or restoration cost (described as the present value of the asset's remaining service potential) instead of the present value of future cash flows expected from the asset. The substance of the definition of a 'non-cash-generating asset' in IPSAS 21 is similar to the substance of the term 'assets held primarily for their service capacity' used in this Exposure Draft. The only noteworthy difference is that under this Exposure Draft's proposals, the counterpart to those assets is assets held primarily for their ability to generate net cash inflows; whereas, under IPSAS 21, the counterpart to 'non-cash-generating assets' is assets held with the primary objective of generating a *commercial* return. Those notions are substantially the same. The Board decided to use the term 'assets held primarily for their service capacity' because this Exposure Draft is concerned with avoiding those assets being written down (inappropriately) to their scrap values. The Board will review the relationship between the terminology in IPSASs and Australian Accounting Standards as part of a broader future review of the similarities and differences between those suites of Standards;

(c) The assets are specialised, where they have been created or adapted for a particular purpose – the Board considers that the scope of its proposal for mandating use of current replacement cost caters for specialised assets. As noted above, the Board concluded that an asset's being specialised should not always be a determining factor for when current replacement cost must be used; and

(d) There are restrictions on what the entity is able to do with the asset – the Board noted that the scope of its proposal for mandating use of current replacement cost is limited to particular restricted assets. However, the Board concluded that an asset's being restricted should not of itself be a determining factor for when current replacement cost must be applied: the non-financial asset must also be held primarily for its service capacity (see paragraph BC57(b)).

~~BC40~~BC58 The Board also considered the United Kingdom *Government Financial Reporting Manual 2019-20* in determining the boundary for its proposed requirement to use current replacement cost. The only category of property, plant and equipment that the Manual identifies as being measured at fair value using IFRS 13 *Fair Value Measurement* is a surplus asset (ie an asset not being used to deliver services, where there is no plan to bring the asset back into use) without any restrictions on sale and that falls within the scope of neither IAS 40 *Investment Property* nor IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* (paragraph 7.1.8). The Manual specifies that when assets are held for their service potential (ie they are

[9] In view of the potential overlap between 'cash-generating assets' and assets held for trading or sale, the Board did not consider referring explicitly to 'assets held for trading or sale' when describing the category/categories of assets for which fair value should not be required to be measured using the cost approach in AASB 13.

operational assets used to deliver either front line services or back office functions) and are specialised, their current value should be measured at the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential (paragraph 7.1.4). The Board observes that the boundary of its measurement proposal (ie assets held primarily for their service capacity) is consistent with the reference in the United Kingdom *Government Financial Reporting Manual 2019-20* to assets held for their service potential.

Whether current replacement cost measurements should include a discount specifically for legal restrictions on the use of assets

~~BC41~~BC59 In relation to the proposed requirement to measure restricted assets at current replacement cost in the circumstances described in paragraph BC49, the Board considered whether an asset's current replacement cost should include a discount specifically for legal restrictions on their use. When an asset's current replacement cost is measured consistently with paragraphs B8–B9 of AASB 13, that amount represents the amount that would be required currently to replace the asset's service capacity. The Board noted that some commentators argue that the imposition of a legal restriction on the use(s) of an asset reduces the asset's service capacity and, therefore, in principle, this reduction should be reflected in the measurement of the asset's current replacement cost.

~~BC42~~BC60 Those commentators also argued that non-financial assets of not-for-profit entities held primarily for their service capacity should not be measured at fair value using the market approach or income approach because the service capacity embodied in such assets should not be measured by reference to the net cash inflows the assets are expected to generate. Similarly, they argued that, if such an asset is subject to a legal restriction on the prices that may be charged for its use, and the asset cannot be acquired with that restriction, the current market buying price of an equivalent but unrestricted asset should not be discounted for the effects of restrictions on the asset's capacity to generate net cash inflows.

~~BC43~~BC61 The commentators referred to in paragraph BC59 gave the example of a local government that acquires land primarily for its service capacity and, on initial acquisition, the land may be dedicated for use as a park, sporting complex, car park, water retarding basin, cemetery or an administration office. The land's service capacity includes the ability to be used in any of these manners. Those commentators consider that if, subsequent to acquisition, the land becomes legally restricted for use only as (for example) a cemetery, the land's service capacity has diminished considerably.

~~BC44~~BC62 To apply the principle referred to in paragraph BC59, it would be necessary to distinguish the following components of the total discount to the current market price of an equivalent but unrestricted asset argued for under Option 1 (see paragraph BC43(a)):

(a) the component relating to the reduction in the net cash inflows that the asset can generate as a result of the legal restrictions affecting the asset, which includes, but is not limited to, any legal restrictions on the prices that may be charged for using the asset (ie a legal restriction on the use of an asset also may affect the net cash inflows the asset may generate); and

(b) the component relating to the legal restriction on the use of the asset.

~~BC45~~BC63 The commentators referred to in paragraph BC59 noted that it would often be exceptionally difficult to measure with reliability the component of the discount referred to in paragraph BC62(b). This is because market evidence for the total amount of the discount is often difficult to find, and this difficulty is exacerbated for the component in (b)—particularly because the two components in paragraph BC62 are often interdependent. The Board agreed with this reasoning.

~~BC46~~BC64 In considering this issue, the Board had regard to the literature of IPSASB, the United Kingdom Government and the International Valuation Standards Committee. Existing IPSASs (in particular, IPSAS 17 *Property, Plant and Equipment* and IPSAS 21 *Impairment of Non-Cash-Generating Assets*) do not indicate that the amount of an asset's depreciated replacement cost would be reduced for the effects of legal restrictions on the asset's use or the prices that may be charged for using the asset. IPSASB Consultation Paper *Measurement* (April 2019) proposes that, in measuring an asset's replacement cost, an entity considers any factors that might affect the cost of replacing the service capacity of the existing asset, and that the asset's existing use will be considered in the light of (among other things) existing restrictions on the use or sale of the land and/or buildings (paragraph D22). The Consultation Paper does not specify whether a discount would be deducted for the effect of such restrictions when measuring the asset's replacement cost.

~~BC47~~BC65 The United Kingdom *Government Financial Reporting Manual 2019-20* does not contain guidance indicating that the cost of replacing an asset's remaining service potential includes a discount for the effect of legal restrictions (paragraphs 7.1.1 – 7.1.14). International Valuation Standard IVS 105 *Valuation Approaches and Methods* does not indicate that the amount of an asset's current replacement cost would be reduced for the effects of legal restrictions on the asset's use or the prices that may be charged for using the asset.

~~BC48~~BC66 The Board concluded that, on balance, an asset's current replacement cost should not include a discount specifically for legal restrictions on its use. Some Board members reached this view because they think the current market buying price of an asset's service capacity would only be reduced for the effect of a restriction if, as a result of the restriction, the asset could be acquired for a lower price. Those Board members observed that, in such a circumstance, the asset would be likely to meet the criteria in paragraph BC35 for measurement at fair value using a market approach ie the circumstance would not arise when current replacement cost is required. Other Board members reached the view that an asset's current replacement cost should not include a discount specifically for legal restrictions on its use because of the practical measurement difficulties of doing so, as referred to in paragraphs BC62–BC63.

Financially feasible use of an asset (paragraph Aus28.1)

~~BC49~~BC67 The Board proposes that the 'financially feasible' use' aspect of a non-financial asset's highest and best use (as described in paragraph 28(c) of AASB 13) should not be applicable to assets of not-for-profit entities that:

(a) are held primarily for their service capacity;

(b) have a legally restricted use or are subject to legal restrictions on the prices that may be charged for using them; and

(c) because an equivalent restricted asset is not obtainable in the marketplace for a price supported by observable market evidence, are measured at their current replacement cost (which is deemed to be their fair value) in accordance with paragraph F6.

~~BC50~~BC68 Paragraph 28(c) of AASB 13 refers to an asset's highest and best use generating an investment return that market participants would require from an investment in that asset put to that use. Without a scope exemption for the non-financial assets that meet all of the tests in paragraph BC67(a)—(c), paragraph 28(c) of AASB 13 might nullify the Board's conclusion that the current replacement cost of a non-financial asset of a not-for-profit entity held primarily for its service capacity—determined in accordance with the guidance on current replacement cost in AASB 13—can exceed the amount on which a market participant buyer could generate a commercial rate of return (see paragraph BC47). Therefore, the Board proposes to exempt from the scope of paragraph 28(c) of AASB 13 the non-financial assets that meet all of the tests in paragraph BC67(a) – (c).

Highest and best use for non-financial assets

Physically possible uses of an asset (paragraph 28(a))

~~BC51~~BC69 Paragraph 28(a) of AASB 13 states that the highest and best use of a non-financial asset takes into account the use of the asset that is physically possible (ie the physical characteristics of the asset, such as its location and size, that market participants would take into account when pricing the asset). The Board was asked by constituents to clarify that some restrictions affecting the fair value of assets are physical rather than legal in nature. For example, those constituents noted that if an entity holds a parcel of land that has been used as a garbage tip, the risk of methane emissions might limit the land's potential uses (eg to only being suitable for conversion to parkland). They argued that using that land as a tip creates a physical restriction on that land affecting the highest and best use that market participants would take into account when pricing that land, regardless of any legal restrictions on the use of the land (ie zoning restrictions) or on the prices that can be charged for using that land. Legal restrictions are the subject of paragraph 28(b) of AASB 13.

~~BC52~~BC70 The Board noted that using that land as a tip affects the physical characteristics of the land that market participants would take into account when pricing the land (ie would limit the use of the land that is physically possible, as referred to in paragraph 28(a) of AASB 13). Therefore, the Board concluded it is unnecessary to modify paragraph 28(a) of AASB 13 to also refer to 'physical restrictions'.

Legal restrictions on the use of an asset or prices charged for using the asset: identification at different levels of a consolidated group (paragraph 28(b))

~~BC53~~BC71 The Board was asked by constituents to provide guidance clarifying whether, in applying paragraph 28(b) of AASB 13, legal restrictions might in some circumstances be treated differently at a parent entity level (e.g. State Government level), compared with an individual entity (e.g. government department) level, when those restrictions were imposed by the parent entity.

~~BC54~~BC72 If a law or regulation imposes a restriction on the use of an asset held by a government department, and this restriction would transfer to any market participant buyer of the asset, paragraph 28(b) of AASB 13 states that the asset's highest and best use would take into account the restriction if market participant buyers would take it into account when pricing the asset. The Board considered whether the restriction should be treated as non-legally binding at the whole-of-government level if the government can rescind the law or regulation. This issue is unique to the public sector, because private sector entities cannot rescind laws.

~~BC55~~BC73 The Board considered that, if a restriction had been imposed by a law that can only be rescinded by parliament (and has yet to be rescinded), the existing legal requirement should be treated as legally binding at the whole-of-government level in addition to being treated as legally binding for the controlled entity (reflecting that the government does not control parliament). In this regard, if a rescission of a restriction has been approved by one House of Parliament but requires approval by another House of Parliament, or requires Royal Assent, the restriction is treated as still requiring rescission by parliament (ie presently legally binding).

~~BC56~~BC74 However, if the existing legal restriction can be rescinded without parliamentary approval, the Board concluded that the restriction should be treated as non-legally binding at the parent entity (e.g. whole-of-government) level, because:

(a) the parent entity has the unilateral capacity to remove the restriction; and, consequently,

(b) the restriction is in effect a self-imposed restriction (even if it was formalised in legislation or a regulation).

~~BC57~~BC75 That is, the measurement of the asset's fair value at the parent entity level should not assume that the restriction would definitely transfer to the market participant buyer in a hypothetical sale at the measurement date if it could be rescinded without parliamentary approval. The measurement of the asset's fair value should reflect the present existence of the restriction but also the parent's option to rescind the restriction. Therefore, the fair value measurement of the parent entity's asset should in principle include the estimated enhancement in value from rescinding the restriction, reduced by the effects of:

(a) the risk that the parent is unable to rescind the restriction. For example, if land is zoned as a park by government regulation and the government has the power to change that zoning (e.g. to allow the land to be used for a freeway extension) without parliamentary approval, it might face strong community opposition to that change in zoning; and

(b) the current cost (if any) of rescinding the restriction, if it could be rescinded. The Board considers that it is appropriate to deduct those costs in measuring the asset's fair value because those costs are analogous to costs of transporting an asset to its marketplace (which are deducted when determining an asset's fair value, in accordance with paragraph 26 of AASB 13).

~~BC58~~BC76 The Board noted arguments that financial reporting should reflect laws currently effective or substantively enacted, regardless of the probability that particular laws will change in the future. Some commentators have argued that treating an existing legal restriction as non-legally binding at the parent entity level would be inconsistent with the treatment of sovereign powers in the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. The IPSASB Conceptual Framework specifies that a government's sovereign power (ie its general ability to establish a power through a statute) only gives rise to an asset when the power is exercised and creates rights to receive resources (paragraph 5.13)[10]. The Board observed that:

(a) as advised to it by professional valuers in outreach activities, current valuation practice in estimating the fair value of land takes into account any material potential that the land will be rezoned for a higher and better use, with any estimated net enhancement reduced for the risk that such rezoning will not occur and the time value of the period until such rezoning is expected to occur (weighted for the different possible periods until rezoning occurs). This practice is consistent with the comments in paragraphs IE7 – IE8 of the IASB's Illustrative Examples accompanying IFRS 13 and paragraphs BC68 – BC69 of the IASB's Basis for Conclusions on IFRS 13 that potential changes in zoning restrictions that market participants would take into account when pricing a property should be considered in the property's fair value measurement unless the alternative use is legally prohibited; and

(b) anticipating rescission of a law or regulation when measuring an asset's fair value does not imply disagreement with the IPSASB's view about anticipating the exercise of a government's sovereign powers. The IPSASB's view about sovereign powers is concerned with the identification and recognition of assets and liabilities—not measurement.

~~BC59~~BC77 In practice, the reliability with which the parent's option could be measured would largely depend on the ability to estimate the probability that the restriction could be rescinded. In some instances in which an existing legal restriction can be rescinded without parliamentary approval, the risk of being unable to rescind the restriction would be very low and could be ignored in the measurement of fair value, on materiality grounds. However, if there is a significant risk of being unable to rescind a restriction and the risk cannot be

[10] The IPSASB Conceptual Framework also states that a government's sovereign power to make, amend or repeal legal provisions, which potentially allows governments to repudiate obligations to other entities, should not be taken into account in determining whether those obligations should be identified as liabilities of the government. That is, the IPSASB concluded that the existence of a liability should be identified by reference to the legal position existing at the reporting date (paragraphs 5.22 and BC5.35).

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estimated reliably, the restriction should be wholly taken into account in the fair value measurement because rescission of a restriction should not be assumed if there is significant doubt that it will occur.

BC78 The Board noted that, if a restriction is considered to be legally binding only at a controlled entity level, different fair value measurements of the asset would be made at the controlled entity and group level, requiring a consolidation adjustment when preparing the consolidated financial statements for the group. The Board observed that precedent exists in Australian Accounting Standards for the need for consolidation adjustments in relation to the same asset. For example, paragraph 15 of AASB 140 *Investment Property* stipulates that, in some circumstances, a property that is investment property of a controlled entity is classified as owner-occupied property from the perspective of the group. Similarly, paragraph 6.3.5 of AASB 9 *Financial Instruments* states that hedge accounting applied at a controlled entity level for transactions between entities in the same group might not be appropriate in the consolidated financial statements of the group.

~~BC60~~BC79 Despite the requirements in some Australian Accounting Standards for consolidation adjustments in relation to the same asset, the Board considered whether an exception should be made from requiring the fair value of the same asset to be measured differently at different levels of a group if a restriction is considered to be legally binding only at a controlled entity level. This consideration was prompted by concerns of Board members about the cost of preparing additional estimates of fair value. The Board decided to include the requirement in the [proposed] Amending Standard but to also to include a Specific Matter for Comment requesting respondents to provide information about the costs to not-for-profit public sector group entities to prepare and report more than one fair value measurement for the same asset and the resulting benefits to users of financial statements of those not-for-profit public sector entities (see Specific Matter for Comment 8).

Current Replacement Cost (paragraphs B8–B9)

Nature of costs included in the current replacement cost of a self-constructed facility

~~BC61~~BC80 The Board was asked to clarify which costs should be included in the current replacement cost of a self-constructed facility (eg a road and the land under the road, whether reported jointly or separately) held by a not-for-profit entity. (This issue excludes consideration of borrowing costs and other finance costs, which are discussed in paragraphs BC112–BC116.) The following comments refer to any measurement of such an asset at current replacement cost, whether under paragraph~~s~~ F6(a), (b) or (c) of the Australian Implementation Guidance for Not-for-Profit Entities.

~~BC62~~BC81 Some commentators have argued that:

(a) a self-constructed facility's current replacement cost should be estimated by assuming that the facility presently does not exist and needs to be replaced from scratch; and

(b) therefore, it is appropriate to base the estimates of current replacement cost on the conditions that existed when the facility was initially constructed. Consequently, they argue, it would be inappropriate to include in a facility's current replacement cost the make-good costs for surrounding facilities of another entity disturbed when the entity's facility is replaced (eg drainage works disturbed when replacing a road) if those surrounding facilities did not exist when the ~~asset~~ entity's facility was initially constructed.

~~BC63~~BC82 Other commentators argue that the current replacement cost of a self-constructed facility should exclude any components of the facility that will not require replacement in the future because their service ~~potential~~ capacity does not expire over time. For example, in relation to a self-constructed road, they argue 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.

~~BC64~~BC83 In relation to these arguments, the Board observed that:

(a) paragraphs B8 and B9 of AASB 13 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 substitute asset of comparable utility, adjusted for obsolescence; and

(b) paragraph BC30 of the IASB's Basis for Conclusions on IFRS 13 *Fair Value Measurement* states that the definition of fair value in AASB 13 (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.

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~~BC65~~BC84 Therefore, the Board concluded that the current replacement cost of assets composing a self-constructed facility includes all necessary costs intrinsically linked to acquiring the facility at the measurement date. This is because a market participant buyer of the entity's facility would need to incur those costs ~~when~~ if it acquires the facility at the measurement date, whether that buyer acquires the facility from the entity or constructs the facility itself. Consequently, in estimating the current replacement cost of a self-constructed facility, it should be assumed that:

(a) the facility presently does not exist (ie the market participant buyer does not presently possess the facility and needs to acquire it from scratch). Because the definition of fair value in AASB 13 assumes a hypothetical exchange transaction, the components of replacement cost included in a facility's fair value are not limited to *actual* replacement transactions expected to occur in the future; and

(b) the facility requires replacing in its current environment, taking into account any make-good costs that must be incurred for surrounding facilities of another entity disturbed when the entity's facility is replaced (eg drainage works disturbed when replacing a road). However, this assumption does not preclude reconfiguring a facility to a more optimal configuration upon replacement.

~~BC66~~BC85 Consequently, the current replacement cost of a facility (whether presented as a part of a single line item or deconstructed into different line items, eg roads and land under roads) would include costs for land or permanent works despite those components not being expected to be replaced. Current replacement cost assumes hypothetical replacement of the facility being measured, and is not limited to costs of replacements actually expected to be incurred in the future.

~~BC67~~BC86 In relation to paragraph BC84(b), the Board concluded that when replacing a facility necessarily disturbs other facilities that are also controlled by the entity, in applying the principle set out in paragraph BC84(a), make-good costs for those other facilities are excluded from the facility's current replacement cost. Thus, the sum of the current replacement costs of each of the entity's facilities would exclude any additional make-good costs relating to the entity's own facilities. Including any make-good costs in those current replacement costs would involve double-counting costs.

~~BC68~~BC87 Further to the argument set out in paragraph BC81(b), another reason some commentators contend why it would be inappropriate to include make-good costs for another entity's surrounding facilities in the current replacement cost of a facility is because those make-good costs do not enhance the service capacity of the facility. The Board disagreed with that contention, because make-good costs for another entity's surrounding facilities necessarily incurred as a result of acquiring or constructing an asset would be included in the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility (as referred to in paragraph B9 of AASB 13). If using the cost approach provides the best estimate of a facility's fair value (selling price), that conclusion indicates the market participant buyer would be prepared to pay all of the costs included in the facility's current replacement cost, provided that current replacement costs exclude any costs resulting from avoidable inefficiencies (eg additional costs resulting from lacking modern technology readily available to market participants).

~~BC69~~BC88 Some commentators expressed concern that, if make-good costs for another entity's surrounding facilities were included in the current replacement cost of a facility without having been incurred during the facility's initial construction, the facility's current replacement cost would increase simply because of a change in the facility's operating environment (ie without the entity having improved the facility). They argued that recognition of such an increase in the facility's fair value through comprehensive income would not faithfully represent the entity's performance, especially since the entity has yet to incur any costs on the surrounding facilities of another entity). The Board observed that:

(a) this concern is similar to the contention discussed in paragraph BC87, but extended in relation to effects on comprehensive income. The Board disagrees with this concern for the same reason it disagreed with the contention in paragraph BC87: a market participant buyer would be willing to pay more for a facility due to the change in the asset's operating environment, despite the asset's capacity to produce outputs not having been improved, because that additional cost is necessarily incurred to obtain access to the net cash inflows, or services, that the asset is expected to generate;

(b) measurement of an asset's fair value under AASB 13 is unaffected by the impacts of resulting remeasurement changes on an entity's comprehensive income; and

(c) the costs of a facility for which a market participant buyer would be prepared to pay are the costs currently avoided by possessing the asset: these costs are not limited to those already incurred by the entity.

~~BC70~~BC89 The Board noted that the IPSASB Consultation Paper *Measurement* (April 2019) includes draft application guidance on replacement cost measurement stating that, regarding site preparation, "Work that may have been undertaken to prepare the actual site for occupation might not need to be carried out on an assumed equivalent site. An entity might therefore assume that the site being valued is level and serviced and ready for development" (paragraph D37). Arguably, this view is consistent with that outlined in paragraph BC82 and rejected by the Board in paragraph BC84(a). However, to the extent that replacement of an asset's service capacity would occur in a more efficient manner (e.g. by relocating a cutting through a hill to where the earth is more stable)—thus avoiding some costs incurred in the existing location of the asset—the statement that "Work that may have been undertaken to prepare the actual site for occupation might not need to be carried out on an assumed equivalent site" might be compatible with the Board's view in paragraph BC84(a). The Board considers that excluding some costs of acquiring or constructing the asset being measured at fair value would clearly be inconsistent with the principles of current replacement cost in paragraphs B8~~—~~B9 of AASB 13, and noted that, in the IPSASB Consultation Paper, replacement cost is not proposed to be used as a measure of fair value.

Economic obsolescence

~~BC71~~BC90 Paragraph B9 of AASB 13 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 as "conditions external to the condition of the machine such as a decline in the market demand for similar machines". An equivalent notion of economic obsolescence of an asset or facility held by a not-for-profit 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 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. The following comments refer to any measurement of a non-financial asset of a not-for-profit entity at current replacement cost, whether under paragraph F6(a), (b) or (c) of the Appendix F *Australian Implementation Guidance for Not-for-Profit Entities*.

~~BC72~~BC91 Some commentators have 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 participant buyers would deduct such an amount from the asset's replacement cost when pricing the asset. This consideration depends on the entity's circumstances, and is not dependent on whether a formal decision has been made to reduce the asset's physical capacity. In some instances, it might be clear that market participant buyers 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 of AASB 13. 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 of AASB 13 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset. 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).

~~BC73~~BC92 The Board noted that part of the debate about when 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 economic obsolescence should not be identified for 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. 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 booms and busts in mining activity. Such apparent overcapacity is similar to standby assets held by entities in either the for-profit or not-for-profit sector to cope with peaks in demand (eg electricity suppliers): 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 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

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(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[11] 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."

Measuring and disclosing the fair value of a composite group of non-financial assets held primarily for their service capacity: effect of multiple legal restrictions

BC93 The Board considered the disclosure implications when different assets within a group of functionally related non-financial assets measured at fair value, such as a facility (eg a public school or public hospital comprising land, buildings and other improvements on the land) are subject to different legal restrictions on their use or the prices that may be charged for using them. In each case where the restrictions are relevant to the measurement and disclosure of the fair value of the assets, the restriction would transfer to a market participant buyer of the asset. When different functionally related assets are subject to different restrictions, they are collectively referred to as a 'composite asset' in the following discussion and paragraph IE11 of the Illustrative Examples. An example of a composite asset is one with:

(a) an easement, covenant or other such encumbrance affecting the land component only and that is reflected in the observable market price of land obtainable in the marketplace; and

(b) a restriction on the use of a facility affecting all of its components (eg a restriction that the facility must be used to provide specified services without charge or at a discount to a commercial price), for which an equivalent restricted asset is not obtainable in the marketplace for a price supported by observable market evidence.

Some assets forming part of a composite asset might be subject to multiple restrictions.

BC94 In principle, a composite group of non-financial assets measured at fair value, grouped for disclosure purposes (eg as a class of assets) and within the scope of paragraph Aus66.1 might include:

(a) one or more components with restrictions that qualify to be treated in accordance with paragraph Aus66.1(a); and

(b) other component(s) with restrictions that qualify to be treated in accordance with paragraph Aus66.1(b), under which the component's current replacement cost is deemed to be its fair value.

BC95 Although different restrictions affecting part or all of a composite group of non-financial assets might appear to qualify for different treatments and, consequently, separate disclosure, it would appear that only rarely would a composite group of non-financial assets include:

(a) one or more components that qualify to be measured solely in accordance with paragraph Aus66.1(a); and

(b) other component(s) that qualify to be measured in accordance with paragraph Aus66.1(b).

BC96 The reason that such an event should occur only rarely (if at all) is that when a restriction affects buildings or other improvements on land, it almost invariably affects the land's legally permitted uses and/or the amounts legally permitted to be charged for using the land. Consequently, if equivalent restricted assets to the improvements are not obtainable in the marketplace, almost invariably an equivalent restricted parcel of land will not be obtainable in the marketplace. This point is illustrated in Illustrative Example 11.

BC97 The circumstance mentioned in paragraph BC96 might arise when a class of land includes parcels of land presently subject to a restricted use and other parcels that are subject to easements but not yet subject to a restricted use. An example of the latter type of land parcel is a parcel held for future use as a cemetery and subject to a legal restriction (eg an easement, covenant or other such encumbrance) reflected in the observable market price of land obtainable in the marketplace. Until the event occurs triggering the land's restriction for use as a cemetery, the parcel of land would be likely to qualify for measurement in accordance with paragraph Aus66.1(a). Other cemetery land (possibly disclosed in the same class of assets) would often qualify for measurement in accordance with paragraph Aus66.1(b). Paragraph Aus92.1 would require the latter category of cemetery land—measured at an amount deemed to be fair value—to be disclosed separately from the former category.

Consistency of measurement principles

BC98 The Board also considered the implications for the consistency of measurement principles of having different assets within a group of functionally related non-financial assets measured at fair value subject to different legal restrictions. If those circumstances (illustrated in paragraph BC93) occurred in practice, it would be important to consider whether adopting different measurement requirements for different restrictions affecting

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

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different components of the same composite asset might involve inconsistent measurement principles. Specifically, it would be important to consider whether it is inconsistent to:

(a) implicitly deduct a discount for an easement within the market price of land, if the effect of the easement is reflected in the observable market price of land obtainable in the marketplace; but

(b) measure some component(s) of the composite asset without deducting a discount from the current market buying price of an equivalent unrestricted asset (eg where a building is permitted only to be used to provide health services without full commercial charge, measuring the current replacement cost of the building—which is deemed to be the asset's fair value—without a deduction compared with the value of that building if it were operated commercially).

BC99 The Board concluded that the two policies in paragraphs BC98(a) and (b) are consistent with the principle enunciated in 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" (ie the asset's current replacement cost, which reflects the most economical price for which the asset's service capacity could be replaced). As noted in paragraph BC34, if an equivalent restricted asset (or component of a composite asset) is obtainable in the marketplace, its market price would incorporate an implicit discount for the effect of the legal restriction, and no market participant buyer (whether a for-profit or not-for-profit entity) would be willing to pay more than the price of the restricted asset (or component)[12]. In contrast, as noted in paragraph BC37, when an equivalent restricted asset (or component of a composite asset) is not obtainable in the marketplace, a not-for-profit entity market participant buyer could not acquire the asset (or component) for an amount incorporating the discount resulting from the restriction. Therefore, that entity would have no choice but to acquire an unrestricted asset (or component), and measurement of that asset (or component) at an undiscounted amount would be consistent with the principle of measuring that asset at the most economical price for which it could be acquired. Therefore, the Board tentatively concluded that the policies in paragraphs BC98(a) and (b) reflect consistent measurement principles.

BC100 The Board also included Illustrative Example 11 to illustrate the interaction of different restrictions affecting different components of composite assets, and related potential disclosure implications for those different components.

Assumed location of real property when measuring the current replacement cost of real property

~~BC74~~BC101 The issue relates to real property of a not-for-profit entity held primarily for its service capacity and measured at current replacement cost by reference to observable market prices of comparable property. Examples of such real property are:

(a) land that is part of a facility such as a public school or public hospital; and

(b) a lessee's right-of-use asset to occupy an office premises.

~~BC75~~BC102 The Board was asked to clarify whether the location of the real property being valued should necessarily be the property's current location. For example, if a facility or right to use an office premises could deliver its services equally well in a nearby location with cheaper property, should 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 paragraph B9 of AASB 13) reflects the price of the property in the cheaper location? The following comments refer to any measurement of an asset described in paragraph BC101 at current replacement cost~~.~~, whether under paragraph F6(a), (b) or (c) of ~~the~~ Appendix F *Australian Implementation Guidance for Not-for-Profit Entities*.

~~BC76~~BC103 Some commentators have argued that the property's market value estimate should reflect the price of suitable property in a cheaper feasible location because paragraph B8 of AASB 13 describes the current replacement cost of an asset as "the amount that would be required currently to replace the service capacity of an asset". They argue that, if the facility or right to use office premises could deliver its services equally well in a nearby location with cheaper property, the service capacity of the entity's land or right to use office premises could be acquired by a market participant buyer at the price of property in the cheaper nearby location. In other words, they argue, 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 adjusted for differences in service capacity, the modern equivalent asset to refer to is nearby property in a cheaper location. Consequently, they argue that ~~T~~the market value premium of property in its current 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

[12] The fair value of assets measured in accordance with paragraph Aus66.1 is not necessarily measured at current replacement cost; however, the principle in paragraph B9 that current replacement cost represents the ceiling on the asset's fair value holds true for all non-financial assets.

Explanation of changes made to the Nov 2019 version

BC101–BC111 have been updated to reflect the Board's decision that the CRC of land forming part of a facility held for its service capacity would always be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility to a site with cheaper land.

of Chartered Surveyors' Guidance Note *Depreciated replacement cost method of valuation for financial reporting* (November 2018)[13]:

> "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)

~~BC77~~BC104 The IPSASB proposed a similar view to that of The Royal Institution of Chartered Surveyors in its Consultation Paper *Measurement* (April 2019), stating that:

> "If there is no locational requirement for the asset, the asset's replacement cost may assume that the notional replacement will be situated on an alternative site which can provide the same service potential in a more cost effective way. However, the location of an asset may impact its replacement cost in situations where a social policy decision has been made requiring the asset to be located in a specific location." (paragraph D4)
>
> "For example, hospitals and schools will ideally be located within the communities they serve; and local authority offices will be easily accessible to all citizens. The land on which these schools, hospitals or offices are built might be in expensive inner-city sites or in town and city centers. Where a social policy decision has been made requiring the asset be located in a specific location, the replacement cost of the land is based on the current value of the existing site, rather than on cheaper land located further away from the communities they serve." (paragraph D5)

~~BC78~~BC105 In contrast, some argue that the current replacement cost of real property should always reflect the property's current 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)

BC106 Similarly, some commentators argue that the current replacement cost of real property should always reflect the property's current location (rather than the price of the property in a cheaper feasible site if one exists) because the property's higher market value in its current location reflects that, from the perspective of market participant buyers, the property provides superior services. That is, market participant buyers are prepared to pay a premium for the service capacity of the property in its existing location (ie office space in a central business district location provides greater service capacity than office space in an inner suburb by, for example, having greater proximity to stakeholders and urban infrastructure and by assisting the entity to attract and retain staff). Those commentators argue that, when using current replacement cost to measure a property's fair value, it should be irrelevant whether the not-for-profit holder of the property values the property's service capacity as highly as market participant buyers. Additionally, some commentators also consider that if the property's service 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, presenting its highest and best use.

[13] 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).

BC107 Having regard to these conflicting views, the Board considered an approach whereby, in principle, the location of the land component of a facility measured at current replacement cost would be determined as follows:

(a) if the facility needs to remain in its present location due to legal restrictions or operational requirements, the land's current replacement cost should reflect the market price of land in that existing location[14]; and

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

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

(ii) the price a market participant buyer 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 be determined as the market price of land in the cheapest legally permissible location compatible with the entity's operational requirements for the facility—which would be the existing site unless an alternative site is cheaper.

BC108 The Board considered that, if such an approach were included in AASB 13, it should be subject to application criteria aimed at limiting its cost of application and ensuring the resulting measurements faithfully represent the current replacement cost of land.

BC109 The approach described in paragraph BC107 and explored by the Board is underpinned by the following principles:

(a) 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)—paragraph BC107(b)(i) refers;

(b) an asset's current replacement cost is estimated by assuming replacement of the asset in the most economical manner that is legally permissible and compatible with the entity's operational requirements for the facility—paragraph BC107(b)(ii) refers; and

(c) a market participant buyer purchasing a facility for its service capacity in its existing use would not be prepared to pay more for the facility than the price incorporating land located on a legally permissible cheaper alternative site if it is compatible with the market participant buyer's operational requirements for the facility, because its alternative course of action is to build a modern equivalent facility in an alternative site if it is cheaper—paragraph BC107(b)(ii) refers.

BC110 However, on further deliberation, the Board observed that such an approach would have the following disadvantages:

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

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

(ii) the present value of the net cash inflows from ~~selling~~ sale of its components at the end of the useful life of the improvements on the land—ie its capacity to subsequently generate net cash inflows for reinvestment in the entity's capacity to provide services (thus, indirectly, another component of the existing facility's service capacity). The best evidence of the land component's capacity to generate net cash inflows from future sale is its current market price in its existing location. This 'reinvestment potential' notion of service capacity is not taken into account by those who contend that applying the principles in paragraphs BC109(b) and (c) can lead to measuring the current replacement cost of land in a cheaper location.[15]

(b) it does not take into account the current replacement cost of the improvements scrapped in moving to an alternative site with cheaper land. Consequently, such an approach could imply an entity's management might in some circumstances make an economically irrational decision to scrap improvements with a current replacement cost that exceeds the saving resulting from relocating a facility to a site with cheaper land ~~location~~, which would be unlikely in practice;~~.~~

[14] The Board's conclusion on this issue is consistent with the IPSASB's proposal in paragraph D4 of its Consultation Paper *Measurement* (quoted in paragraph BC91).

[15] An example of the importance of the 'reinvestment potential' aspect of a non-financial asset's service capacity is where a not-for-profit entity holds an inner urban road and the land under the road as a facility primarily for its service capacity. If the road would be replaced with a tunnel if it needed replacement, the land formerly under the road could be sold or leased out. If the market value of that land were to be excluded from the measurement of the current replacement cost of the facility (land and land under road), the service capacity of the facility would be understated.

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(c) it is unnecessarily complex, since in most cases its application would result in measuring the current replacement cost of land in its present location; and

(d) even with the application criteria referred to in paragraph BC108, identifying the higher of the values in paragraphs BC107(b)(i) and (ii)—including potentiall~~y~~ need~~ing~~ to identify, and assess the current replacement cost of, multiple alternative sites—would often:

(i) be time-consuming and costly for preparers and auditors of financial statements; and

(ii) create challenges in developing among choices a representationally faithful measure of the existing land's current replacement cost.

BC111 In light of the concerns in paragraph BC110, the Board decided not to propose requiring application of the approach in paragraph BC107, and concluded that the current replacement cost of land forming part of a facility of a not-for-profit entity held primarily for its service capacity would be measured by assuming it is replaced in its present location, even if it would be feasible to relocate the facility to a cheaper site. This principle is expressed slightly more broadly in paragraph F26 of the Appendix F *Australian Implementation Guidance for Not-for-Profit Entities*, to also encompass a lessee's right-of-use asset to occupy an office premises.

Borrowing costs and other finance costs

~~BC79~~BC112 The Board was asked to provide guidance to not-for-profit entities (particularly those in the public sector) 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 (eg 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, regardless of whether that measurement basis is adopted in accordance with proposed paragraph Aus66.1 of AASB 13 or in applying paragraphs B8–B9 of AASB 13 to specialised assets held primarily for their ability to generate net cash inflows. The issue raised is distinct from the question of whether not-for-profit ~~public sector~~ entities should capitalise borrowing costs into the cost of qualifying self-constructed assets, which is addressed in AASB 123 *Borrowing Costs*.

~~BC80~~BC113 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of a self-constructed 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.[16]

~~BC81~~BC114 The Board considers that a not-for-profit 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.

~~BC82~~BC115 The Board noted that some commentators argue that a not-for-profit public sector entity should exclude borrowing costs from the current replacement cost of a self-constructed asset if that entity elects, under paragraph Aus8.1 of AASB 123 *Borrowing Costs*, not to capitalise borrowing costs into the cost of qualifying assets. The Board considers that the accounting policy choice for borrowing costs made by an entity under AASB 123 is irrelevant to how those costs should be treated when measuring a self-constructed asset's fair value. 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 costs and the measurement of current value are fundamentally different processes. Therefore, there should be no presumption that the treatment of borrowing costs should be consistent for both.

~~BC83~~BC116 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. International Valuation Standard IVS 105 *Valuation Approaches and Methods* includes:

> "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)

16 The AASB provided guidance on the treatment of borrowing costs when measuring an asset's current replacement cost, in paragraphs IE8 and IE17-IE21 of the Illustrative Examples in AASB 1059 *Service Concession Arrangements: Grantors*. However, this guidance applies to a much narrower range of entities than AASB 13 and does not give rise to a risk of inadvertent or inappropriate use of additional guidance by publicly accountable for-profit entities that may result in non-IFRS compliance (in the context of the AASB's Not-for-Profit Entity Standard-Setting Framework, May 2018, paragraph 32(c)).

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Right-of-use assets under concessionary leases

Introduction

~~BC84~~BC117 AASB 16 *Leases* is effective for annual reporting periods beginning on or after 1 January 2019, and replaces the former distinction between operating leases and finance leases for lessees. Subject to an optional practical expedient, under AASB 16, lessees recognise a right-of-use asset and a lease liability for all leases.

~~BC85~~BC118 AASB 1058 *Income of Not-for-Profit Entities*, also effective for annual reporting periods beginning on or after 1 January 2019, originally required not-for-profit entity lessees to measure right-of-use assets at fair value on initial recognition, in respect of leases with significantly below-market terms and conditions principally to enable the entity to further its objectives. Such leases were referred to as 'concessionary leases' in the Board's Basis for Conclusions on AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* (see paragraph BC119): that term is used in this Exposure Draft.

BC119 In response to comments from constituents that they were encountering difficulties in determining the fair value of right-of-use assets in concessionary leases, the Board issued AASB 2018-8 *Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities* in December 2018 to provide a temporary option for not-for-profit entities to elect to measure these right-of-use assets at initial recognition either at cost or at fair value, with that election made for each class of right-of-use assets. The Board also issued AASB 2019-8 *Amendments to Australian Accounting Standards – Class of Right-of-Use Assets arising under Concessionary Leases* in December 2019 to extend the above-mentioned temporary option in AASB 2018-8 to provide a temporary option for the Whole of Government and the General Government Sector not to measure right-of-use assets arising under concessionary leases at fair value in subsequent measurement. AASB 2019-8 specifies for not-for-profit entities that right-of-use assets arising under concessionary leases can be treated as a separate class of right-of-use assets to right-of-use assets arising under other leases for the purposes of applying AASB 16.

~~BC86~~BC120 Constituents had encountered difficulties in determining how to take into account the effect on fair value of:

(a) restrictions on the right to use the assets underlying the lease; and

(b) the specialised nature of many underlying assets.

~~BC87~~BC121 This Exposure Draft proposes guidance to assist not-for-profit entity lessees in measuring the fair value of right-of-use assets under concessionary leases. The Board will consider comments on this Exposure Draft as part of its process of deciding whether to convert the temporary relief provided through AASB 2018-8 into a permanent option for not-for-profit entity lessees to elect to measure right-of-use assets under concessionary leases on initial recognition either at cost or at fair value.

~~BC88~~BC122 The Board's considerations underlying this Exposure Draft's proposed guidance on concessionary leases are discussed separately below in relation to:

(a) the fundamental principles for measuring the fair value of the above-mentioned right-of-use assets (see paragraphs BC123–BC130); and

(b) specific issues in respect of measuring right-of-use assets under concessionary leases, including the distinction between right-of-use assets and the underlying asset, and the effect of restrictions and the specialised nature of underlying assets (see paragraphs BC131–BC141).

Fundamental principles for measuring the fair value of right-of-use assets under concessionary leases (paragraphs Aus66.1 – Aus66.2, ~~and F3~~F6 and F15~~–~~–F19 ~~– F4~~)

~~BC89~~BC123 As noted in paragraph BC118, concessionary leases of not-for-profit entities are leases with significantly below-market terms and conditions principally to enable the not-for-profit entity to further its not-for-profit objectives. Right-of-use assets under concessionary leases are often subject to lessor-imposed restrictions on those rights, which, at the very least, require the asset to be used for the lessee's service-delivery objectives. Even where not-for-profit entity lessees hold unrestricted right-of-use assets under concessionary leases, those assets almost invariably are held primarily for their service capacity rather than for their ability to generate net cash inflows. Consequently, not-for-profit entity lessees' right-of-use assets under concessionary leases are, almost invariably, assets that are held primarily for their service capacity rather than their ability to generate net cash inflows.

~~BC90~~BC124 In light of the nature of not-for-profit entity lessees' right-of-use assets under concessionary leases, the Board tentatively concluded that the fundamental principles for measuring the fair value of not-for-profit entities' other non-financial assets held primarily for their service capacity should also apply to those entities' right-of-use assets as lessees under concessionary leases. In reaching this tentative conclusion, the Board considered that, although the fair value of right-of-use assets will typically differ from the fair value of the

Note to the Board

At the Nov 2019 meeting, the Board instructed staff to convert guidance on concessionary ROU assets in the Basis of Conclusions into Illustrative Examples. These have now been included as Examples 6-10 in the Illustrative Examples.

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assets underlying those rights (see paragraph BC132), the principles for measuring the fair value of owned assets and leased assets (rights of use) should be the same.

~~BC91~~BC125 Accordingly, the Board proposes, consistent with paragraphs Aus66.1–Aus66.2 and paragraphs F15–F16, requiring the following for a not-for-profit entity lessee's right-of-use asset under a concessionary lease:

(a) if the right-of-use asset is held primarily for its ability to generate net cash inflows, its fair value is measured using whichever of the market approach, cost approach or income approach (or a combination of them) is the most appropriate in the circumstances. This is an unmodified requirement of AASB 13. An example is donated leased space that becomes surplus to the not-for-profit entity lessee's operational requirements and is sub-leased by that not-for-profit entity;

(b) if the right-of-use asset is held primarily for its service capacity, and the asset has neither a legally restricted use nor is subject to a legal restriction on the prices that may be charged for using it, its fair value is measured using whichever of the market approach, cost approach or income approach (or a combination of them) is the most appropriate in the circumstances. This is also an unmodified requirement of AASB 13. An example is a lessor's surplus office space leased without charge to a charity, where either:

    (i) the charity's (reporting entity's) uses of the leased space are unrestricted; or

    (ii) the lease terms restrict the charity from using the office space for another purpose than its charitable purposes but the restriction would not transfer to a market participant buyer of that right-of-use asset (ie under AASB 13.28(b), the restriction is not a restriction that would be taken into account when measuring the fair value of the right-of-use asset); ~~This is~~as illustrated in Illustrative Examples 6 ~~. Illustrative Example~~and 8A ~~provides another illustration of measuring the fair value of a right-of-use asset the uses of which are unrestricted;~~ and

(c) if the right-of-use asset is held primarily for its service capacity, and the asset has a legally restricted use or is subject to a legal restriction on the prices that may be charged for using it (and either restriction is asset-specific, ie it would transfer to a market participant buyer):

    (i) if an equivalent restricted right-of-use asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence (which would ~~impound~~ incorporate the discount resulting from the restriction), the asset is measured at fair value based on the available market evidence for the equivalent restricted asset. Typically, the resulting fair value estimate would ~~be calculated as~~ reflect the present value of the market rentals for the restricted asset, discounted at a market-based asset-specific rate of discount. This is illustrated in Illustrative Example 7; and

    (ii) if an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is (subject to a 'reliable measurement' criterion: see paragraph BC126) measured at its current replacement cost. The asset's current replacement cost is determined consistently with paragraphs B8–B9 of AASB 13, without a discount to the current market buying price of an equivalent but unrestricted right-of-use asset. ~~For example, a community centre is granted a concessionary lease for the real property on which it operates, which may only be used by it, or any acquirer of its right-of-use asset (eg sub-lessee), to provide community services. There is no observable evidence of market rentals for similarly restricted rights of use within the vicinity of the community centre. Consequently, the community centre measures its right-of-use asset at current replacement cost, which is calculated using a market comparison approach for leases of unrestricted real property in the vicinity. Current replacement cost would, for these restricted right-of-use assets, be estimated as the present value of market rentals (t~~This is illustrated in Illustrative Examples 8B–8C and 9~~8)~~. The reason this measure is termed 'current replacement cost' is that, to replace the service capacity embodied in the right-of-use asset, the entity would need to acquire a right-of-use to an unrestricted underlying asset~~—~~. ~~t~~The Board considered that, in such cases, it ~~is~~ would be unclear whether the resulting measurement would conform to the principles in IFRS 13 for measuring the fair value of the right-of-use asset, because neither the market approach nor the income approach to measuring fair value would be permitted to be applied in preference to the cost approach. ~~and c~~Consequently, the Board proposes requiring the right-of-use asset measured at current replacement cost (which is deemed to be fair value) to be presented separately from right-of-use assets (and other assets) measured at fair value without needing to be deemed to be measured at fair value.

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BC126 In relation to paragraph BC125, the Board also proposes that, ~~if~~ in the exceptional cases in which there is clear evidence when an entity first acquires a right-of-use asset that neither the fair value nor the current replacement cost of ~~-~~that right-of-use asset can be measured reliably:~~,~~

(a) the presumption that a not-for-profit entity lessee can reliably measure the fair value or current replacement cost (which is deemed to be the fair value) of its right-of-use asset is rebutted; and, consequently,

(b) -the right-of-use asset should initially be measured at the same amount as the lease liability (see paragraphs Aus66.2 and F4).

BC127 This circumstance in paragraph BC126arises when, and only when:

(a) neither an equivalent right-of-use asset~~s~~ is obtainable in the marketplace at the measurement date for a price supported by observable market evidence nor are alternative reliable estimates of current replacement cost (eg based on discounted cash flow projections) available; or

(b) the current replacement cost of the right-of-use asset can only be estimated by reference to available evidence of the current replacement cost of the underlying asset that is the subject of the lease, and evidence of the difference between the current replacement cost of the underlying asset and of the right-of-use asset is unavailable. This can only occur when:

(i) the underlying asset creates valuable rights other than rights of use and the current replacement cost of those additional rights cannot be estimated reliably; or

(ii) the lease term is materially shorter than the estimated economic life of that underlying asset and, because in the entity's specific circumstances the pattern of consumption of the underlying asset's service capacity cannot be estimated reliably, it is impossible to determine the portion of the underlying asset's current replacement cost that is attributable to the right-of-use asset.

BC128 In relation to paragraph BC127(a), discounted cash flow projections may be used to estimate the current replacement cost of a right-of-use asset because observable market rentals for comparable right-of-use assets (although primarily considered when using the income approach to estimate fair value) are inputs in estimating the amount required currently to replace the service capacity of a right-of-use asset.

~~BC92~~BC129 The Board decided upon this ~~proposal~~ proposed reliable measurement criterion in BC126 because it is consistent with the stipulation in paragraph 31 of AASB 116~~.31~~ that an item of property, plant and equipment shall be carried at a revalued amount only when its fair value can be measured reliably. The Board considers that a 'reliable measurement' criterion should also apply to the measurement of an asset at current replacement cost when it is deemed to be the asset's fair value. The 'reliable measurement' criterion is specified explicitly only in relation to using current replacement cost to measure the right-of-use asset, because (under paragraphs Aus66.1(a) and F6(c)(i)) fair value is used to measure such an asset only when its price is supported by observable market evidence (ie the 'reliable measurement' criterion is implicit in paragraphs Aus66.1(a) and F6(c)(i)).

~~BC93~~BC130 In applying the fundamental principles referred to in paragraph BC125, where market rentals are used to estimate the fair value of the right-of-use asset (including where they are used to estimate current replacement cost deemed to be fair value), it is important to:

(a) factor in any rent-free periods typically offered for the type of asset as a lease inducement; and

(b) use a discount rate that is asset-specific. For example, for a public sector entity lessee, it would be inappropriate to use the ~~government's~~ incremental borrowing rate for the government in the entity's jurisdiction unless that rate coincided with an asset-specific rate of discount~~;~~.

Specific issues in respect of measuring right-of-use assets under concessionary leases

~~BC94~~BC131 Paragraphs BC131–BC141 ~~BC98 – BC106~~ set out the Board's response to various issues raised by not-for-profit entity constituents regarding measuring the fair value ~~(or current replacement cost)~~ of right-of-use assets under concessionary leases.

~~BC95~~BC132 The fair value of a right-of-use asset will, in principle, differ from the fair value of the underlying asset that is the subject of the lease, because:

(a) the term of the lease typically will be shorter than the economic life of the asset underlying the lease; and

(b) ownership of an underlying asset conveys rights additional to the right to use the asset, including:

(i) the right to sell the asset and the right to pledge the asset as security for a loan; and/or

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(ii) when the asset is leased out, the right to benefit from the asset's residual value and the right to charge third parties for other rights to use the same underlying asset (where the leased-out asset has separate mutually compatible uses).

Consequently, it is often necessary for a fair value estimate of a right-of-use asset to be calculated as the present value of the market rentals for using the underlying asset, discounted at a market-based asset-specific rate of discount. However, for non-cancellable leases with a lease term materially the same as the economic life of the asset underlying the lease, the fair value of the right-of-use asset might be materially the same as the fair value of that underlying asset. This is illustrated in Illustrative Example 8C.

Legal restrictions

~~BC96~~BC133 When a not-for-profit entity lessee has a right-of-use asset with a legally restricted use or a legal restriction over the prices that may be charged for using that asset, the Board concluded that the existence of the restriction (if asset-specific) should be dealt with as follows in measuring the right-of-use asset:

(a) if the right-of-use asset is held primarily for its ability to generate net cash inflows, its fair value is measured using whichever of the market approach, cost approach or income approach (or a combination of them) is the most appropriate in the circumstances (see paragraph BC125(a)). To the extent that the restriction reduces the net cash inflows market participant buyers of the right-of-use asset would expect to generate from the asset, it would reduce the asset's fair value (either directly, where the market approach or income approach is used, or indirectly by applying market approach or income approach estimates as a cross-check under paragraph 63 of AASB 13 to an estimate developed under the cost approach);

(b) if the right-of-use asset is held primarily for its service capacity, and an equivalent restricted right-of-use asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is measured at fair value based on the available market evidence for the equivalent restricted asset. To the extent that the restriction reduces the estimated market price of the right-of-use asset, it would reduce the asset's fair value (see paragraph BC125(c)(i)); and

(c) if an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the asset is measured at its current replacement cost. The asset's current replacement cost is determined without a discount to the current market buying price of an equivalent but unrestricted right-of-use asset, ie the restriction does not reduce the value of the right-of-use asset (see paragraph BC125(c)(ii)). Consequently, when an equivalent restricted right-of-use asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the need to estimate the value of the discount to the current market buying price of a reference asset—which could otherwise have been a significant challenge to reliably measuring the right-of-use asset—does not arise.

Right to terminate a lease

~~BC97~~ Paragraphs B34–B35 of AASB 16 and BC128–BC129 in the Basis for Conclusions on IFRS 16 provide guidance in determining the lease term of the contract, including situations when the lessor and/or the lessee has the option to terminate the lease. B35 indicates that if only the lessor has the option to terminate a lease, the lessee ignores the lessor's right to terminate the lease when determining the non-cancellable lease term. However, in terms of the fair value measurement of right-of-use assets arising under a concessionary leases, some valuers provided feedback to the Board that the fair value of such right-of-use assets arising under concessionary leases where a lessor has the right to terminate the lease without course is likely to be low due to the uncertainty of the term. Therefore, as a practical expedient, the fair value of such right-of-use asset should be deemed to be immaterial.

BC134

Specialised right-of-use asset

~~BC98~~BC135 A not-for-profit entity lessee may possess a right-of-use asset that is specialised because its use is legally restricted. In such instances, the ramifications of being specialised are reflected in paragraph BC133's description of how restrictions are taken into account when measuring the fair value ~~or current replacement cost~~ of a right-of-use asset under a concessionary lease. The other main ramification of a right-of-use asset under a concessionary lease being specialised (whether legally restricted or not) is that the availability of market evidence for estimating the asset's fair value ~~or current replacement cost~~ might be limited significantly. ~~In rare instances,~~ In exceptional cases, neither the fair value nor current replacement cost (deemed to be the fair value) of a specialised right-of-use asset will be capable of reliable measurement. The Board concluded that, in such a case, the asset should initially be measured ~~using the contractual lease payments (if any) in the concessionary lease~~ at the same amount as the lease liability (see paragraph BC126).

~~BC99~~BC136 For some highly specialised right-of-use assets held primarily for their service capacity, determining a reliable measure of their current replacement cost (which is deemed to be their fair value) might be achievable by measuring the underlying asset, if the lease term is materially the same as the entire estimated economic life of the underlying asset. This is illustrated in Illustrative Example 8C~~An example is where a government agency constructs an infant health clinic in a remote area and grants a right to use that clinic for its entire estimated economic life to another not-for-profit entity under a concessionary lease. If the clinic (and, therefore, the not-for-profit entity lessee's right-of-use asset) has no alternative use, the current replacement cost of the clinic would be a reasonable estimate of the current replacement cost of the lessee's right-of-use asset~~.

Right-of-use asset is measured as a resource

~~BC100~~BC137 The Board observed that an entity's ability to measure reliably the fair value of a right-of-use asset (an input to a process) is different from the entity's ability to measure the value of the services or other outputs that the asset will produce, particularly as those outputs are often produced by using the right-of-use asset in combination with other resources such as employee services, consumable supplies and intangible assets (eg intellectual property). ~~For example, if a not-for-profit research entity is a lessee of laboratory space under a concessionary lease, the value of its right-of-use asset is not determined by estimating the highly uncertain net cash inflows or other value that using the laboratory space will generate (ie the value created by conducting the research). Instead, the value of the space as an input (ie a resource) will depend on how market participant buyers price that space in its highest and best use.~~This is illustrated in Illustrative Example 10. Consequently, an entity's ability to measure reliably the fair value of a right-of-use asset does not depend on the ability to measure reliably the value of the services or other outputs the asset will produce.

Ability to pay

~~BC101~~BC138 The Board observed that the fair value of a right-of-use asset under a concessionary lease does not depend on the amount that the not-for-profit entity lessee would have been able, or prepared, to pay for that right if it had not been granted through a concessionary lease. Paragraph 2 of AASB 13 states that fair value is a market-based measurement, not an entity-specific measurement. Consistent with that principle, the fair value of a right-of-use asset (eg a right to use office space acquired as a lessee under a non-cancellable lease) is not less than the price that a market participant buyer (eg a for-profit entity) is prepared to pay for that asset. A lesser amount that the reporting entity is willing to pay is a characteristic of that entity, and not of the asset. This is illustrated in Illustrative Example 6.

~~BC102~~BC139 In this regard, the Board noted that the principle of fair value in AASB 13 assumes a hypothetical sale by the holder of the asset, even if its sale is legally prohibited (see paragraph BC30 of the IASB's Basis for Conclusions on IFRS 13). Under paragraph IE29 of the IASB's Illustrative Examples for IFRS 13, legal restrictions on an asset's uses (or on the prices that may be charged for using the asset) are limited to those that would transfer with the asset to the market participant buyer in the hypothetical sale transaction that is the subject of the fair value estimate. Therefore, an entity's being restricted in its ability to sell an asset, or inability to afford to pay the market price of an asset, does not affect the fair value of an asset it holds.

~~BC103~~BC140 The Board observed that not-for-profit entities are inherently dependent on a degree of financial support in the form of transfers of financial and non-financial assets without giving equivalent value directly in return; it is representationally faithful to report the full value of the service ~~potential~~ capacity they control, and of the financial support they receive (and rely on) to pursue their mission. The Board also concluded that this is equally the case for transfers of non-financial assets to those not-for-profit entities as it is for transfers of cash to those entities. It also concluded that there is no more of a case to take an entity's ability to pay into account when measuring a right-of-use asset under a concessionary lease than there is when measuring the current value of precious artworks bequeathed to a not-for-profit entity on the condition that those artworks are displayed to the public without charge.

~~BC104~~BC141 Furthermore, the Board observed that measuring assets at the amount an entity is able to pay, when that amount differs from the amount that market participant buyers would be prepared to pay, would create generally insurmountable difficulties in reliably measuring those assets. This is because such an amount would depend on entity-specific circumstances, including the extent of financial support to the entity, which is inherently subjective and can be highly changeable.

Effective Date and Transition

BC142 In accordance with paragraph 7.9.2 of *the AASB Due Process Framework for Setting Standards*, the Board decided to propose that mandatory application of the amendments stemming from this proposed Standard should commence from the first annual period beginning two years from the date of issue of the Amending Standard. In practice, that would mean entities and their auditors would have at least two years from the issue of the Amending Standard before they must apply its amendments to AASB 13. The Board decided that proposed period of transition because:

(a) there is widespread diversity in practice among not-for-profit entities regarding some issues addressed by the proposed amendments, and consequently it would be desirable to avoid any unnecessary delay in adopting those amendments; and

(b) the Board customarily provides a period of two to three years between issue and mandatory application of major new Standards; because this is a proposed Amending Standard, a two-year period should be adequate for implementing the amendments (in this regard, the Board noted that one of the most significant potential amendments stemming from application of the proposed Amending Standard would be ceasing in particular circumstances to deduct a discount for the effect of a legal restriction from the current market buying price of an equivalent but unrestricted asset—such an amendment should be reasonably straightforward).

BC143 Nevertheless, the Board is mindful that some of the other proposed amendments might be less straightforward to implement, and has included a Specific Matter for Comment on the mandatory effective date of the Amending Standard.

BC144 The Board considered whether to require not-for-profit entities to apply the amendments to AASB 13 resulting from this [proposed] Amending Standard retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* or prospectively. Applying amended requirements retrospectively in accordance with AASB 108 entails adjusting the opening balance of each affected component of equity for the earliest prior period presented, and the other comparative amounts disclosed for each prior period presented, as if the new accounting policy had always been applied (paragraph 22). Prospective application of a new accounting policy does not involve restatement of comparative amounts disclosed in respect of each prior period presented.

BC145 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)."

BC146 However, the Board observed that:

(a) where practicable, it is preferable to adopt changes in accounting policies arising from new or amended Accounting Standards retrospectively, because retrospective application enhances the comparability of current period and comparative (prior period) amounts disclosed in the financial statements of the reporting period of initial application of the new accounting policies; and

(b) there should be significant aspects about which a change in the methods used to measure fair value resulting from initial application of the amendments in this [proposed] Amending Standard should be separable from an underlying change in the fair values of the affected non-financial asset. For example, one of the most significant changes in accounting policy in this [proposed] Standard would be where, in applying paragraph Aus66.1(b), a particular not-for-profit entity ceases to deduct a discount from the current market buying price of an equivalent but unrestricted asset for the effect of a legal restriction on the use of a non-financial asset or the prices that may be charged for using the asset. Reversing the effect of the discount on comparative amounts of those assets disclosed in respect of prior periods should be practicable, because the amount of the discount previously deducted should have been documented in respect of those prior periods.

BC147 The Board noted that initial application of the [proposed] amendments to AASB 13 might entail other changes in accounting policies by particular not-for-profit entities, where the amounts that would have been determined in respect of prior periods presented if the new accounting policies had always been applied are more difficult to determine with reliability. For example, retrospective application of the [proposed] amendments might entail restating comparative amounts in respect of:

(a) adopting the cost approach instead of the market approach or income approach to measure the fair value of particular assets;

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

(c) changing the assumed location of land from that assumed in prior period estimates of current replacement cost; and

(d) right-of-use assets arising as lessees in concessionary leases, where those assets have not previously been measured at fair value.

BC148 The Board observed that AASB 108, paragraph 23, specifies that retrospective application of a new accounting policy does not apply to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change. AASB 108 includes the following definition of 'impracticable': "Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort

> **Note to the Board**
>
> The draft discussion of the transitional provisions, as set out in paragraphs BC142-BC151, is based on the Board's discussion at its November 2019 meeting to require the proposals to be applied retrospectively.

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to do so. For a particular prior period, it is impracticable to apply a change in accounting policy retrospectively … if:

(a) the effects of the retrospective application … are not determinable;

(b) the retrospective application … requires assumptions about what management's intent would have been in that period; or

(c) the retrospective application … requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

(i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and

(ii) would have been available when the financial statements for that prior period were authorised for issue from other information." (AASB 108, paragraph 5)

BC149 The Board considers that the relief in AASB 108 from having to retrospectively apply a new accounting policy when retrospective application is impracticable should largely, if not entirely, overcome concerns about the availability of information to support retrospective application of the amendments to AASB 13 in this [proposed] Amending Standard.

BC150 The Board considers it preferable to require retrospective restatement where practicable rather than requiring prospective application of all changes in accounting policy and forsaking the enhanced comparability of restatements of comparative information that would be practicable to make on initial application of the [proposed] Amending Standard.

BC151 However, the Board also notes that requiring retrospective restatement for new accounting policies except when impracticable might result in additional time and costs involved in assessing whether particular restatements are impracticable, and the potential for disagreements about this between preparers and auditors of financial statements of not-for-profit entities measuring non-financial assets at fair value. On balance, the Board considers the benefits of requiring retrospective application (with attendant exemption for impracticability of restatements) are likely to outweigh the costs. This Exposure Draft includes a Specific Matter for Comment on this issue, which asks respondents to provide information (quantitative as well as qualitative, where possible) to assist the Board in weighing up the costs and benefits of this proposed transitional requirement.

Comparison with IFRS Standards

BC152 Not-for-profit entities that comply with this Standard might not be in compliance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).

BC153 This Standard requires the fair value of certain non-financial assets not-for-profit entities held primarily for their service capacity to be measured at current replacement cost (paragraph Aus66.1). However, IFRS 13 does not specify which valuation technique to use. Instead IFRS 13 requires the use of valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Three widely used valuation techniques set out in IFRS 13 are the market approach, the cost approach and the income approach. The requirement of this Standard to measure certain assets at current replacement cost in accordance with the cost approach might not be compliant with IFRS 13.

Question 11 to the Board

Do Board members have any comments on the Basis for Conclusions as currently drafted?

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