FATAL-FLAW REVIEW VERSION
Comments due to the AASB no later than Friday, 11 November 2022

AASB Standard

AASB 2022-X
[Month] 2022

Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

[AASB 13]

Australian Government

Australian Accounting Standards Board

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Australian Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* is set out in paragraphs 1–9. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2022-X

This Standard makes amendments to AASB 13 *Fair Value Measurement* (August 2015) for application by not-for-profit public sector entities.

Main features of this Standard

Main requirements

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

(a) specifies that the asset's current use is presumed to be its highest and best use unless it is highly probable at the measurement date that the asset will be sold, distributed, or used for an alternative purpose to its current use;

(b) clarifies that an asset's use is 'financially feasible' if market participants would be willing to invest in the asset's service capacity, considering both the capability of the asset to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services;

(c) specifies that, if both the market selling price of a comparable asset and some market participant data required to measure the fair value of the asset are not observable, an entity uses its own assumptions as a starting point and adjusts those assumptions to the extent that reasonably available information indicates that other market participants would use different data; and

(d) provides guidance on how the cost approach is to be applied to measure such an asset's fair value.

Application date

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

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Comments due to the AASB no later than Friday, 11 November 2022

Accounting Standard AASB 2022-X

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

Keith Kendall
Dated … [date] Chair – AASB

Accounting Standard AASB 2022-X
Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

Objective

1 This Standard amends AASB 13 *Fair Value Measurement* (August 2015), including adding authoritative implementation guidance and providing related illustrative examples, for application by not-for-profit public sector entities.

Application

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

3 This Standard applies to annual periods beginning on or after … [1 January 2024]. This Standard may be applied to annual periods beginning before … [1 January 2024].

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, Aus29.1, Aus29.2 and Aus93.2 are added. Paragraphs 28, 29 and 93 are not amended but are included for reference.

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) …

(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.

<u>Aus28.1</u> <u>Notwithstanding paragraph 28(c), for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, an asset's use is financially feasible if market participants (including not-for-profit public sector entities) would be willing to invest in the asset's service capacity, considering both the</u>

capability of the asset to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services.

29 Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

Aus29.1 Notwithstanding paragraph 29, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the asset's current use is presumed to be its highest and best use unless at the measurement date it is highly probable that the asset will be sold, distributed, or used for an alternative purpose to its current use.

Aus29.2 For the purposes of paragraph Aus29.1, it is highly probable that the asset will be:

(a) sold or distributed when it is classified as held for sale or held for distribution in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*; and

(b) used for an alternative purpose to its current use when all of the following conditions are met:

(i) the alternative purpose for the asset is physically possible, legally permissible and financially feasible in accordance with paragraphs 28 and Aus28.1;

(ii) the appropriate level of management is committed to a plan to change the usage of the asset to that alternative purpose, and an active programme to complete the plan has been initiated;

(iii) the asset is immediately available to be used for the alternative purpose in its present condition;

(iv) any approvals required to change the asset's usage have been obtained;

(v) actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(vi) the change in the asset's use is expected to be completed within one year from the measurement date.

…

Disclosure

…

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Standard) in the statement of financial position after initial recognition:

(a) …

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

…

Aus93.2 For the purposes of paragraph 93(i), for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the asset's current use is presumed to be its highest and best use unless, in accordance with paragraphs Aus29.1 and Aus29.2, it is highly probable that the asset will be sold, distributed or used for an alternative purpose to its current use.

6 Paragraph AusC6.1 is added to Appendix C *Effective date and transition*.

AusC6.1 AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities*, issued in … [Month] 2022, amended AASB 13 for application by not-for-profit public sector entities, including adding Appendix F *Australian implementation guidance for not-for-profit public sector entities*. A not-for-profit public sector entity shall apply those amendments prospectively for annual periods beginning on or after … [1 January 2024]. Earlier application is permitted. If an entity applies AASB 2022-X for an earlier period, it shall disclose that fact.

7 Appendix F *Australian implementation guidance for not-for-profit public sector entities* is added as set out on pages 8–10 of this Standard.

8 *Australian illustrative examples for not-for-profit public sector entities* is attached to accompany AASB 13 as set out on pages 11–15 of this Standard.

Commencement of the legislative instrument

9 For legal purposes, this legislative instrument commences on … [31 December 2023].

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

This appendix is an integral part of the Standard. It describes the application of paragraphs 22, 23, 61, 89, B8 and B9 of the Standard. The appendix applies only to not-for-profit public sector 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 prepared this appendix to explain and illustrate the application of the principles of paragraphs 22, 23, 61, 89, B8 and B9 of the Standard by not-for-profit public sector entities in relation to fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows. This appendix does not apply to for-profit entities or not-for-profit private sector entities or affect their application of AASB 13.

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

F2 Paragraph 22 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. Paragraph 23 states that, in developing those assumptions, an entity need not identify specific market participants; and paragraph 89 states that (in relation to unobservable inputs for an asset) an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.

F3 Unobservable inputs are defined as inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability. Paragraph 87 states that unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Paragraph 89 states that, in developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy).

F4 Various non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, especially some that are specialised, do not have observable market selling prices or other observable market data because entities seldom sell those assets until their economic life has expired (ie there is little market activity for the asset or comparable assets at the measurement date). Consequently, in applying the requirement of paragraph 61 for fair value estimates to maximise the use of relevant observable inputs, it may nonetheless be necessary to develop unobservable inputs to estimate their fair value. Moreover, for assets that are unique to a government, observable evidence of assumptions of other market participants, if any, is unlikely to differ from the entity's own assumptions.

F5 Accordingly, when applying the principles in paragraphs 61 and 62 to measure the fair value of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, if both the market selling price of a comparable asset and some market participant data required to measure the fair value of the asset are not observable, the entity shall use its own assumptions as a starting point and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

F6 For the purposes of paragraph F5, if no relevant information about other market participant assumptions is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset. Exhaustive efforts need not be undertaken to identify whether relevant information about other market participant assumptions is reasonably available or whether the entity's own data should be adjusted. However, when information about market participant assumptions is reasonably available, an entity cannot ignore that information.

F7 For the purposes of paragraph F5, for assets with various inputs to their fair value estimate, observable market data might be available for some inputs, in which instances unobservable inputs would only be used for the remainder of the asset's fair value estimate. For example, the land component of a self-constructed specialised facility might have comparable land with an observable market price, but entity-specific data might be needed to measure the fair value of some or all of the improvements on that land included in the fair value estimate for the facility.

Application of the cost approach (paragraphs B8 and B9)

F8 Paragraphs B8 and B9 state 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), based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

F9 Accordingly, when measuring the fair value of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows (the subject asset) using the cost approach, an entity estimates the current replacement cost of the subject asset by estimating the cost currently required for a market participant buyer to acquire or construct a reference asset in accordance with paragraphs F11–F15, and:

(a) adjusting that estimate for any differences between the current service capacity of the reference asset and the subject asset (for example, where the modern equivalent asset would be engineered to a higher standard than the subject asset, which might occur where the asset was self-constructed but its replacement by a modern equivalent is most likely to occur through a service concession arrangement whereby the reference asset is designed to provide services for an economic life longer than that of the subject asset); and

(b) adjusting for any obsolescence.

F10 A reference asset is a suitable alternative to the subject asset that the market participant buyer would consider in developing its pricing assumptions about the subject asset. Identifying the most appropriate reference asset involves the application of judgement and, on occasion, detailed valuation assessments in the circumstances of the subject asset. A reference asset could be a modern equivalent asset or a replica asset (where the utility offered by the subject asset could be provided only, or more cheaply, by a replica rather than a modern equivalent asset). A modern equivalent asset is an asset that provides similar function and equivalent utility to the subject asset, but is of a current design and constructed or made using current cost-effective materials and techniques.

Estimating the replacement cost of a reference asset

F11 For the purposes of paragraph F9, when estimating the cost currently required for a market participant buyer to acquire or construct a reference asset, an entity:

(a) assumes the reference asset will be acquired or constructed at the subject asset's existing location; and

(b) where paragraph F5 applies, shall use its own assumptions as a starting point in measuring the costs currently required to acquire or construct a reference asset and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

F12 When applying paragraphs F9 and F11, the entity shall, subject to paragraph F14, include the following costs (among other costs) in the reference asset's replacement cost if they would need to be incurred upon the hypothetical acquisition or construction of a reference asset with the same service capacity (including condition) as the subject asset at the measurement date:

(a) costs required to restore another entity's asset, if the asset that would need restoration existed at the measurement date and would be disturbed in a hypothetical acquisition or construction of the reference asset. However, such costs are excluded if they relate to restoration of an asset of another entity included in the consolidated group (if any) to which the entity belongs;

(b) other disruption costs that would hypothetically be incurred when acquiring or constructing the reference asset at the measurement date (eg costs of redirecting traffic when replacement of the asset, such as a drainage pipe, disrupts the operation of a road); and

(c) if the subject asset is fixed to a parcel of land, site preparation costs for the reference parcel of land on which the reference asset would hypothetically be constructed, unless those site preparation costs are reflected (explicitly or implicitly) in the fair value measurement of the subject parcel of land.

F13 For the purposes of paragraph F12(c), site preparation costs include, but are not limited to:

(a) costs required to prepare the land (eg earthworks and decontamination) for the hypothetical construction of the reference asset; and

(b) costs required to remove and dispose of any unwanted existing structures on the land to make way for the hypothetical construction of the reference asset.

F14 An entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraphs F12 and F13. However, an entity shall include all such costs for which data are reasonably available.

F15 When applying the cost approach in accordance with paragraph F9 to measure the fair value of a heritage asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, to the extent that its heritage features are an essential part of its service capacity, replacement cost generally means the cost of replicating those features of the subject asset (ie reproduction cost). Replication would assume reconstruction using modern cost-effective materials and processes, but sympathetic with the original heritage design and structure to the extent feasible.

Economic obsolescence

F16 When a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows has suffered a reduction in demand for its services, the identification of 'economic (ie external) obsolescence' (referred to in paragraph B9) does not require a formal decision to have been made to reduce the physical capacity of that asset.

F17 When an asset described in paragraph F16 apparently has surplus capacity in view of current demand for its services, economic obsolescence is not identified for that asset if that 'surplus capacity' is necessary for stand-by or safety purposes (eg to deal with contingencies), even if it seldom or never is actively utilised. An example of an asset with stand-by capacity that is necessary for operational purposes, and would be replaced in full by a market participant buyer, is an electricity generation plant that maintains a generating capacity buffer that is typical of the industry to cater for periods of peak demand.

F18 An example of a strong indicator that economic obsolescence of assets would be identified when applying the principles in paragraphs F16 and F17 is a public school's buildings that have a capacity for 500 students but, due to demographic changes, a school for 100 students would meet current and reasonably foreseeable requirements, including a buffer needed for any temporary or underestimated student demand. In this example, based on these assumed facts alone (for simplicity), the school buildings' gross replacement cost would be based on the school's needed capacity (for 100 students), from which any other accumulated obsolescence related to the condition of the school buildings (eg physical obsolescence) would be deducted. Consistent with paragraph F16, the conclusion reached would not depend on whether a formal decision has been made to reduce the school buildings' capacity.

F19 Where an asset or a facility that is not held primarily for its ability to generate net cash inflows suffers a significant reduction in demand for its services, any economic obsolescence identified would not necessarily (and frequently would not) exhibit a linear relationship with that reduced level of demand. This is because some parts of an asset or a facility might need to be replaced in full, or almost in full, despite a significant fall in demand for the services provided by the asset or facility (eg in the school example, the administration office, cafeteria, toilet blocks, library and gymnasium might need replacing even for 100 students, although perhaps on a slightly smaller scale).

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

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

The IASB published Illustrative Examples accompanying IFRS 13 Fair Value Measurement*, which are available on the AASB website. Those IASB examples illustrate aspects of IFRS 13 but are not intended to provide interpretative guidance. Those examples portray hypothetical situations illustrating the judgements that might apply when an entity measures assets and liabilities at fair value in different valuation situations. The following examples illustrate aspects of Appendix F* Australian implementation guidance for not-for-profit public sector entities *in AASB 13. They complement the IASB's Illustrative Examples.*

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

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

Nature of costs included in current replacement cost before deducting obsolescence (paragraphs F9–F14)

IE2 Examples 1–4 illustrate the costs included in the current replacement cost (before deducting obsolescence) of a non-financial asset not held primarily for its ability to generate net cash inflows under the cost approach in paragraphs B8 and B9, and in paragraphs F9–F14.

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

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

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

Year ending 30 June 20X2

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

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

Direct physical costs and design work costs	Estimated cost as at 30 June 20X2
	$'000
Design work	2,200
Earthworks	10,000
Formation	5,000
Pavement	3,000
Surfacing	2,000
Total	22,200

<u>Costs to remove unwanted existing structures and disruption costs</u>

Council A's road is situated in a densely populated area, and when the road was constructed there were no vacant sites in the surrounding area. Consequently, Council A needed to acquire land and incurred $2,000,000 to remove unwanted structures on the land to make way for the construction of the road. Council A assesses that, since there is no vacant site in the surrounding area as at 30 June 20X2, to construct the road in a hypothetical acquisition, a market participant buyer would also need to incur a similar cost (which it estimated to be unchanged at $2,000,000 as at 30 June 20X2). Council A did not reflect any land improvement or remediation costs in the fair value of the land under the road.

In addition, because the Council's road construction work required interruption of power and water supplies, the majority of the construction work occurred at night-time to minimise disruption to the community. Council A incurred $1,000,000 disruption costs when constructing the road (which it estimated to be unchanged at $1,000,000 as at 30 June 20X2). It is estimated that if those night-time construction works were performed during the day time, those disruption costs could have been reduced to $500,000 as at 30 June 20X2. Council A determined that there is no reasonably available information indicating that another market participant would construct a road at the location of the Council's road during the daytime.

<u>Current replacement cost assessment as at 30 June 20X2</u>

Costs to a market participant buyer

In accordance with paragraphs F8 and F10, Council A concludes that each of the estimated costs listed above (which total $22,200,000) and the other necessarily incurred costs analysed below should be included in the road's current replacement cost because all components of the road, including the once-only earthworks and formation works, would need to be undertaken in a hypothetical replacement of the road at the measurement date. This is because the cost to a market participant buyer to acquire or construct a substitute road of comparable utility at the asset's existing location would include each of those costs, including any intrinsically linked disruption costs (eg traffic control and detour costs).

Costs of removal and disposal of unwanted existing structures

In addition, Council A includes the estimated costs of removal and disposal of unwanted existing structures at $2,000,000 as at 30 June 20X2 in the road's current replacement cost. This is because it is reasonable to expect that a market participant buyer would need to incur such costs if it was to construct a substitute road at the asset's existing location since there is no vacant land available in the area.

Disruption costs

Since there is no reasonably available information indicating that another market participant would construct a road at the location of the Council's road during the daytime, Council A uses the more costly night-time disruption costs of $1,000,000 in its estimated current replacement cost of the road as at 30 June 20X2 rather than the lower daytime costs.

Consequently, Council A measures the road's current replacement cost (before deducting any obsolescence) as at 30 June 20X2 as $25,200,000 (ie $22,200,000 + $2,000,000 + $1,000,000).

Example 2 – Difference in the asset's operating environment affecting the current replacement cost of a road

In this example, the costs and circumstances set out in Example 1 also apply to another local government (Council B), and it is also assumed that:

- as at 30 June 20X2 another entity's drainage works were situated under the road;
- Council B determines that, if its road was to be replaced as at the measurement date of 30 June 20X2, the other entity's drainage works would be disrupted;
- the current costs required to restore those drainage works disrupted during the hypothetical replacement of the components of Council B's road (ie another type of intrinsically linked disruption cost) is $2,500,000; and
- Council B is not part of a group of entities that prepares consolidated financial statements.

<u>Current replacement cost assessment as at 30 June 20X2</u>

Restoration costs for disrupted assets of another entity

In addition to the replacement cost estimate of $25,200,000 (as per Example 1), Council B also includes in its road's current replacement cost as at 30 June 20X2 the $2,500,000 restoration costs for the drainage works necessarily disrupted during hypothetical replacement of the road's components.

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

Consequently, as at 30 June 20X2, Council B measures its road's current replacement cost (before deducting any obsolescence) as $27,700,000 (ie $25,200,000 + $2,500,000).

Example 3 – Whether to adjust the entity's own assumptions in measuring a non-financial asset

The Transport Department of a Government (Department B) estimates the fair value of its railway tracks as at 30 June 20X1 using the cost approach. Department B determined that there are no observable market prices for completed suitable railway tracks, and not all other market participant data required to measure the fair value of carriages are observable.

The cost currently required to acquire or construct Department B's modern equivalent railway tracks would be 30% lower if they were manufactured overseas instead of in Australia. There is no legal requirement for the tracks to be manufactured in Australia. However, the Commonwealth Government provides significant funding assistance for both the public sector and the private sector to acquire or replace public transport assets. The policy is that at least 50% of federally co-funded asset acquisitions must be manufactured in Australia. The State Government controlling Department B has identified railway tracks as one of the asset types the replacement of which contributes to meeting that domestic 50% requirement.

Based on the Commonwealth Government's policy regarding Australian-manufactured content, Department B assesses that replacement of the railway tracks would, in the ordinary course of operations, be achieved by their manufacture in Australia. There is no reasonably available information indicating that another market participant would acquire railway tracks overseas.

Current replacement cost assessment as at 30 June 20X1

In accordance with paragraphs F5 and F11(b), Department B estimates the cost currently required for a market participant buyer to acquire or construct a reference asset by using its own assumptions as a starting point and adjusting those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

Since there is no reasonably available information indicating that another market participant would acquire railway tracks overseas, Department B uses the more expensive costs of Australian manufacture in its estimated current replacement cost of the railway tracks as at 30 June 20X1, notwithstanding the absence of a legal requirement for their manufacture in Australia.

Site preparation costs (paragraph F12(c))

IE3 In respect of a non-financial asset not held primarily for its ability to generate net cash inflows and measured under the cost approach in paragraphs B8 and B9, Example 4 illustrates how a particular entity treats site preparation costs, in accordance with paragraph F12(c), when measuring the fair value of assets at current replacement cost.

Example 4 – Costs of decontaminating land

Health Department C was transferred land in a State Park on 1 July 20X0, to be used to construct a quarantine facility.

Department C:

(a) recognises land and improvements on land as separate classes of asset;

(b) incurred $25 million (excluding any site preparation costs) to construct the facility building. The construction was completed in June 20X1;

(c) measures the fair value of the facility building at current replacement cost under the cost appraoch; and

(d) has an accounting policy to recognise any site preparation costs as part of the fair value of improvements on land where the fair value of the improvements is measured at current replacement cost under the cost approach.

As at 30 June 20X1, the fair value of the facility building (the subject asset) was estimated. For simplicity:

(a) it is assumed that the value of land in the proximity of the State Park, and any site preparation costs, did not change between 1 July 20X0 and the measurement date of 30 June 20X1;

(b) the cost to construct the facility building did not change since its construction; and

(c) the profit margin attributed to any site preparation costs by market participants when pricing the subject asset is ignored.

The site preparation costs determined in accordance with paragraph F12(c) are analysed for the following three scenarios:

(a) Scenario A: The transferred land was contaminated, and Department C incurred $5 million to decontaminate the land. Available land in the proximity of the State Park was also contaminated; and

(b) Scenario B: The transferred land was contaminated, and Department C incurred $5 million to decontaminate the land. Available land in the proximity of the State Park was uncontaminated.

(c) Scenario C: The transferred land was uncontaminated. Available land in the proximity of the State Park was contaminated.

Site preparation cost assessments as at 30 June 20X1

Scenario A

It would be expected that another market participant buyer would need to incur $5 million to decontaminate the reference parcel of land to be a fit-for-purpose site for the modern equivalent quarantine facility building, since the only available land in the proximity is also contaminated. Department C measures the fair value of the quarantine facility as at 30 June 20X1 as $30 million.

Scenario B

It would be expected that another market participant buyer could hypothetically purchase uncontaminated land, in which case, it would not need to incur the $5 million decontamination cost. Using the cost approach, the fair value of the quarantine facility building is $25 million.

Scenario C

It would be expected that another market participant buyer, being unable to acquire uncontaminated land (to hypothetically construct a modern equivalent building) as an alternative to acquiring Department C's building, would be prepared to pay for the cost of decontamination when pricing the facility building. Department C measures the fair value of the quarantine facility as at 30 June 20X1 as $30 million ($25 million construction cost and $5 million decontamination cost), despite the fact that it did not incur any decontamination costs when the facility building was actually constructed.

Including the $5 million decontamination cost in the fair value measurement of the facility building represents the advantage for a market participant buyer to possess Department C's building (ie would be considered by a market participant buyer when pricing the building). The advantage of possessing Department C's building is that a market participant buyer would avoid the need to incur decontamination costs to prepare a contaminated parcel of land for construction of a reference asset.

Economic obsolescence (paragraphs F16–F19)

IE4 Example 5 illustrates an assessment of whether economic obsolescence should be identified in relation to an asset not held primarily for its ability to generate net cash inflows, if the asset is measured at current replacement cost under the cost approach in paragraphs B8 and B9.

Example 5 – Kitchen with underutilised potential

A not-for-profit public sector institute (College A) measures the furniture and fittings in its college building at fair value using the cost approach. Its furniture and fittings include a kitchen of commercial standard necessary for training student chefs. The current cost to replace the teaching kitchen with an identical capacity kitchen, less all forms of obsolescence other than any economic obsolescence, is estimated as at the measurement date (30 June 20X3) as $250,000. Based on College A's schedule of classes, the kitchen is used four hours per week. The kitchen is an essential asset for College A to fulfil its teaching objectives, although it is not utilised outside the scheduled class times.

Current replacement cost assessment as at 30 June 20X3

College A assesses whether any economic obsolescence of its teaching kitchen has arisen as at the measurement date (30 June 20X3).

Although the teaching kitchen is operated with less intensity than physically possible, this does not indicate economic obsolescence has arisen. This is because the teaching kitchen is necessary for College A to fulfil its teaching objectives and is achieving the level of output planned. Another college 'stepping into the shoes' of College A would be willing to pay $250,000 to replace the kitchen's service capacity.

Therefore, no economic obsolescence is deducted from the amount of $250,000, which is the kitchen's current replacement cost as at 30 June 20X3.

Basis for Conclusions

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

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard, which amends AASB 13 *Fair Value Measurement* for application by not-for-profit public sector entities. It sets out the reasons why the Board developed the Standard, the approach taken to developing the amendments and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

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

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

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

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

Diversity and inconsistency in applying the requirements of AASB 13

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

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

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

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

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

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

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

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

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

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

Due process

Fair Value Project Advisory Panel

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

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

Stakeholder feedback on the IPSASB's Measurement project

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

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

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

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

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

BC15 In accordance with paragraph 20 of *The AASB's Approach to International Public Sector Accounting Standards* (October 2019), in May 2021 the Board issued ITC 45 *Request for Comment on IPSASB Exposure*

Drafts ED 76 Conceptual Framework Update: Chapter 7, *Measurement of Assets and Liabilities in Financial Statements and ED 77* Measurement, to obtain Australian stakeholders' views on the IPSASB's proposals.

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

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

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

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

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

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

BC19 At the date of issue of this Standard, the IPSASB was continuing to develop a Measurement Standard and related amendments to its Conceptual Framework based on its proposals in ED 76 and ED 77.

Stakeholder feedback on AASB ED 320

BC20 The Board considered the comments received on ITC 45 and continued developing guidance to assist not-for-profit public sector entities to apply the principles of AASB 13 more consistently in measuring their non-financial assets not held primarily for their ability to generate net cash inflows, in addressing the stakeholders' requests noted in paragraph BC7.

BC21 The Board issued Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* in March 2022 to propose adding authoritative implementation guidance on how to apply the following principles in measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows:

(a) the market participant assumptions to use;

(b) the circumstances in which the asset's current use is presumed to be its highest and best use;

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

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

BC22 Another key purpose of developing additional guidance is to enable application of AASB 13 in a more cost-effective manner by clarifying its application, including clarifying the extent to which preparers of financial statements need to search for information in the absence of observable market inputs.

BC23 ED 320 was exposed for 90 days, and the Board conducted three virtual roundtables to elicit feedback on the proposals. The Board received sixteen written submissions and observed that:

(a) generally, stakeholders support modifying AASB 13 (to varying degrees) to assist not-for-profit public sector entities in applying the principles noted in paragraph BC21; but

(b) significant refinements would be needed in the drafting of the modifications to address potential application issues.

BC24 The Board considered the feedback on ED 320 and revised the drafting of the modifications. In October 2022, the Board issued a Fatal-Flaw Review draft version of the Standard to identify any unintended consequences of the revisions made to the proposed modifications.

BC25 The Board observed that the modifications to AASB 13:

(a) would not necessarily change practice for some not-for-profit public sector entities; and

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

The highest and best use of a non-financial asset not held primarily for its ability to generate net cash inflows

BC26 The Board noted that AASB 13 paragraph 29 states a rebuttable presumption that an asset's current use is its highest and best use. AASB 13 paragraph 29 states that "… an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset."

BC27 Regarding whether the current use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is presumed to be its highest and best use, the Board observed that IFRS 13 paragraph 29 (quoted in paragraph BC26) and the related IASB Basis for Conclusions paragraph (quoted below) provide guidance:

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

BC28 However, despite that IASB text, some stakeholders requested the Board to provide additional guidance about the highest and best use of non-financial assets referred to in paragraph BC27. These stakeholders do not consider the cost incurred to search for possible alternative uses of such an asset is justified when such an asset is very unlikely to be used for a purpose other than its current use for the many cases in which the asset is:

(a) specialised, especially if the costs to convert the asset to the alternative use are high; and

(b) being used to provide necessary services to the public and, therefore, the public sector entity holding the asset is highly likely to continue using the asset to provide those services.

BC29 The Board considered the request and decided to modify AASB 13 to reduce the cost and effort of an entity searching unnecessarily for possible alternative uses of a not-for-profit public sector entity's non-financial asset not held primarily for its ability to generate net cash inflows. This is discussed in paragraphs BC32 to BC57.

BC30 In addition, stakeholders requested the Board to provide guidance assisting not-for-profit public sector entities to apply the three concepts specified in AASB 13 paragraph 28 for identifying the highest and best use of non-financial assets not held primarily for their ability to generate net cash inflows (which has practical effect when the presumption that the asset's current use is its highest and best use is rebutted). The Board decided that, in respect of such assets, implementation guidance is needed for the 'financially feasible use' concept in paragraph 28(c) of AASB 13, but implementation guidance is not needed regarding the application of the 'physically possible use' and 'legally permissible use' concepts in paragraphs 28(a) and 28(b). The Board's views on the 'physically possible use' and 'legally permissible use' concepts are set out in paragraphs BC58–BC74.

BC31 The Board concluded that, although the 'financially feasible use' concept should apply to fair value measurements of any non-financial asset, for an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, AASB 13 paragraph 28(c) should be clarified in terms relevant to the not-for-profit public sector environment. Therefore, the Board added paragraph Aus28.1 in AASB 13. This is explained in paragraphs BC75–BC77.

The presumption that an asset's current use is its highest and best use (paragraphs Aus29.1 and Aus29.2)

Proposal in ED 320

BC32 The Board proposed in ED 320 that, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the asset's current use – to provide particular public services – should be presumed to maximise the value of the asset unless evidence exists that, at the measurement date, the appropriate level of management of the entity has committed to a plan to sell (including distribute) the asset or to use the asset for an alternative purpose. The Board considered that if a not-for-profit public sector entity has committed to a plan to sell such an asset or to use the asset for an alternative use, the entity would have determined that the alternative use will generate greater benefits than its current use. In this case, the highest and best use of that asset would be the planned alternative use (if that alternative use is physically possible, legally permissible and financially feasible in accordance with AASB 13 paragraph 28).

BC33 For an asset subject to a committed-to plan of sale by an appropriate level of management, a conclusion that the asset's highest and best use differs from its current use could be reached earlier than when the asset meets the classification requirement as 'held for sale' under AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*. Under AASB 5 paragraphs 6–8, among other conditions, a non-current asset is classified as held for sale only if the asset is available for immediate sale and its sale must be highly probable. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. In addition, subject to limited exceptions, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, and it must be unlikely that significant changes to (or withdrawal of) the plan will occur.

BC34 Under the Board's proposal in ED 320, for an asset subject to a committed-to plan of sale by an appropriate level of management, to conclude that the asset's highest and best use differs from its current use, the entity's appropriate level of management need not have initiated at the measurement date an active programme to:

(a) locate a buyer; or

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

Stakeholder feedback on ED 320 and the Board's redeliberations

BC35 Eleven of the twelve ED respondents who responded to this topic expressed support for modifying AASB 13 to limit the circumstances in which the current use presumption is rebutted. The respondent who disagreed with any modification to AASB 13 that would constrain identifying a higher and better alternative use of an asset considered that the hypothetical transaction underpinning the fair value concept in AASB 13 should be supported by actual market activity or the generation of actual cash flows that support assumptions about what that market activity might be. They consider that if an asset's fair value measurement does not reflect its market value, it would inadvertently affect an entity's assessment of the true cost of the assets being deployed for service delivery.

BC36 That respondent was concerned that the ED proposals would affect fair value measurements of some public sector assets due to:

(a) the subjective assessment by an entity's management of whether an asset is held primarily for its ability to generate net cash inflows;

(b) the decision by the entity's management about how the asset will be used; and

(c) the notion of a hypothetical not-for-profit public sector entity market participant buyer being ethereal and lacking market activity on which to base a fair value estimate.

BC37 In response to that respondent's concerns, the Board observed that the notion of hypothetical not-for-profit public sector market participant buyers is key to not measuring the fair values of many specialised public sector entity assets at scrap value. This is supported by the IASB's Basis for Conclusions on IFRS 13, paragraph BC78, which states that "… In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset." Also, the IASB noted in paragraph BC79 of its Basis for Conclusions that sometimes an observed market price – one for sale on a stand-alone basis – will not reflect an asset's fair value (because it does not reflect the value that the specialised asset contributes to the entity, which is achieved by using the specialised asset in combination with other assets).

BC38 The Board considered that the IASB's rationale provides an equivalent precedent for hypothetical not-for-profit public sector market participant buyers existing for public sector entity assets at a higher level of aggregation than the unit of account for observed sales of individual public sector assets. In addition, the Board concluded that fair value estimates for non-financial assets not held primarily for their ability to generate net cash inflows should not depend on the net cash inflows expected to be generated by those assets.

BC39 The Board made reference to paragraphs 25 and 30 of the *AASB Not-for-Profit Entity Standard-Setting Framework*, which states that, when justified, the Board would make modifications to IFRS Standards to address not-for-profit specific issues, including:

(a) undue widespread and significant diversity in accounting practices (paragraph 25(e)); and

(b) the cost or effort of preparing and disclosing information outweighs the benefits to users (paragraph 30(h)).

BC40 The Board acknowledged the concern that limiting the circumstances in which the current use presumption may be rebutted could result in some fair value measurements being non-compliant with IFRS 13 because they might delay the identification of a higher and better alternative use compared with application of paragraph 29 of IFRS 13 alone.

BC41 However, the Board considered that this potential for IFRS non-compliance should be insignificant. This is because the Board considers that a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows:

(a) often is different in nature from an asset with similar features but held primarily for its ability to generate net cash inflows, because the nature of the benefits it provides is different;

(b) is subject to a different operational (public sector) environment that reduces the likelihood – compared with that of an asset held by a private sector entity – of realising a potential opportunity to be sold for a higher and better alternative use, and therefore reduces the relevance of such an opportunity to assumptions made by market participants when pricing the asset;

(c) if specialised, is unlikely to be used for another purpose, especially if the costs to convert the asset to an alternative use are high; and

(d) often is being used to provide necessary services to the public and, therefore, another not-for-profit public sector entity stepping into the shoes of the public sector entity holding the asset would base its pricing decisions on the asset's current use.

BC42 Even if particular fair value measurements under the proposed modifications to AASB 13 were considered not to be compliant with IFRS 13, the Board concluded they would be justified on cost-benefit grounds. The proposal regarding the identification of an asset's highest and best use is designed to reduce the cost and effort of a not-for-profit public sector entity searching unnecessarily for possible alternative uses of an asset.

BC43 Some Board members consider that if AASB 13 is modified to specify when the asset's current use ceases to be its highest and best use, doing so should drive more consistency between the asset's use and the asset's value reported on financial statements, rather than reporting the asset's value based on a possible alternative use. In addition, the proposal would not restrict the choice of valuation techniques to apply in measuring a not-for-profit public sector entity's asset.

Timing of when the current use presumption is rebutted

BC44 Although the significant majority of ED respondents agreed with modifying AASB 13 to limit the circumstances in which the current use presumption is rebutted, some ED respondents disagreed that an entity's appropriate level of management having committed to a plan to sell the asset would, of itself, be sufficient to require an entity to reassess the asset's highest and best use (with a potential consequence that the asset's fair value would be remeasured). Those respondents argued that reassessing the asset's highest and best use should not occur until the asset has met the criteria for classification as 'held for sale' under AASB 5 and/or formal approval has been made to sell or distribute the asset.

BC45 They noted that, under the proposal in ED 320, when the asset subsequently meets the criteria for classification as 'held for sale' under AASB 5, another fair value estimate would need to be determined for the asset, and expressed concern that this outcome would cause undue cost and effort. They argued that, unlike for most assets held by for-profit entities, the sale of various assets held by not-for-profit public sector entities requires a complex and lengthy approval process (sometimes requiring legislative amendment) that can cause the elapse of a significant period between when an asset satisfies the 'committed-to plan to sell the asset' condition proposed in ED 320 and when the criteria for classification as 'held for sale' in AASB 5 are satisfied. For these reasons, they argued that applying the ED proposals would:

(a) give rise to a significant risk of premature (and additional) remeasurement because of the greater risk of changes in management plans stemming from the complexity of public sector processes for selling or redeploying assets;

(b) give rise to a significant risk of information leakage regarding sales of assets during a confidential tender process;

(c) obligate controlled entities to seek information about decisions by senior levels of government to which they might not be privy until sale of an asset becomes highly probable and/or imminent (ie when the criteria for classification as 'held for sale' are met). This is because, in the public sector environment, sometimes the plan to dispose of or redeploy an asset is initiated by a controlling entity of the holder of the asset, and the asset's holder does not learn of this plan until later (because the sale process for the asset is conducted confidentially for some time). Similarly, until an asset is ready for sale in the condition intended by an entity's appropriate level of management, a higher and better use for the asset is unlikely to be evident;

(d) be potentially difficult and subjective to apply, because it would often be difficult in a public sector environment to determine exactly when an entity's appropriate level of management has become 'committed to a plan' to sell an asset, and consequently be likely to result in significant diversity in practice; and

(e) not be consistent with a GAAP/GFS harmonisation objective, because being 'committed to a plan to sell an asset' is not an explicit concept that can be applied from a macroeconomic statistics perspective.

BC46 For the reasons in paragraph BC45, those respondents argued that this issue is a public-sector-specific issue that warrants deeming that a higher and better use than current use does not arise until an asset satisfies the criteria for classification as 'held for sale' under AASB 5.

BC47 In developing ED 320, the Board was concerned that waiting until all the conditions in AASB 5 for classifying an asset as 'held for sale' are met could deprive users of financial statements of a not-for-profit public sector entity of useful information about an alternative use having become an asset's highest and best use, as supported by the due diligence underpinning a decision by the entity's appropriate level of management to commit to a plan to take one of those steps. For example, if an appropriate level of management commits to begin using an asset (such as equipment) for a commercial purpose (eg by leasing out that equipment) while awaiting approval of the asset's sale, it could deprive users of information about the asset's value if an entity waits until the classification conditions for being 'held for sale' in AASB 5 are met before taking into account the commitment to change the asset's use.

BC48 On balance, the Board considered that the concerns noted in paragraph BC45 outweigh these concerns in paragraph BC47. In addition, the Board noted that:

(a) in the public sector, many non-financial assets other than land are specialised assets without alternative uses; and

(b) the requirements of AASB 5 are well understood by preparers and auditors of financial statements of not-for-profit public sector entities. Therefore, aligning the timing of identifying a higher and better alternative use with the criteria in AASB 5 should reduce the time and effort by preparers and auditors and reduce inconsistency in application.

BC49 Therefore, the Board decided to:

(a) specify in paragraphs Aus29.1 and Aus29.2 that reassessing an asset's highest and best use should not occur until the asset has met the criteria for classification as 'held for sale' under AASB 5; and

(b) include a statement in the Comparison with IFRS 13 that, for the reason in paragraph BC40 (and the reasons in paragraphs BC228 and BC229), fair value measurements of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows might not be compliant with IFRS 13.

BC50 In reaching its decision referred to in paragraph BC49, the Board considered the other alternative to the ED proposals expressed by respondents, namely, identifying a higher and better use of an asset upon formal approval of selling or distributing the asset. The Board concluded that this other alternative would not sufficiently address the concerns expressed by respondents regarding the proposal in ED 320, because formal approval of sale or distribution can precede sale by an extended period. In contrast, the AASB 5 criteria for an asset being 'held for sale' include that the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

BC51 Consistent with ED 320, and in contrast with AASB 5, the Board considered that it is not essential that a higher and better alternative use of an asset is only identified through a future sale of the asset: the asset's higher and better alternative use could be identified through future redeployment for an alternative purpose. Substantially the same point for identifying a higher and better alternative use of an asset should apply to assets that would be sold or redeployed.

BC52 The Board decided that the overarching principle for identifying a higher and better alternative use is that the sale or alternative use must be 'highly probable'. In the case of an asset with a higher and better alternative use identified from a future sale or distribution, the 'highly probable' test would be met when the asset meets the criteria for classification as 'held for sale' under AASB 5 (see paragraph Aus29.2(a)). For an asset with a higher and better alternative use identified from a future redeployment, the 'highly probable' test would be met when the asset meets the criteria in paragraph Aus29.2(b) – these criteria parallel those in AASB 5, but focus on redeployment rather than sale.

BC53 Due to the unique characteristics of decision-making structures in the public sector, some stakeholders requested the Board to provide guidance on who might be the appropriate level of management of an entity for the purposes of applying paragraphs Aus29.1 and Aus29.2. The Board considered that an entity needs to apply judgement in determining the appropriate level of management, which will depend on the facts and circumstances of individual assets. In this context, the appropriate level of management might depend on, for example, the asset's significance, the requirements (legislative and policy) and conventions for decision making in the public sector, and the resulting governance structure affecting the not-for-profit public sector entity.

BC54 The Board observed that typical examples of the appropriate level of management of an entity holding an asset not primarily for its ability to generate net cash inflows would include a local government council, the entity's chief executive officer and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government.

BC55 It should be noted that if a non-financial asset's alternative use is identified as its highest and best use and the alternative use has a primary purpose of generating net cash inflows, the asset would subsequently be outside the scope of this Amending Standard.

Disclosure where the highest and best use of an asset differs from its current use

BC56 AASB 13 paragraph 93(i) includes the following disclosure requirement: "… for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use." Some ED respondents commented that there is uncertainty whether the proposed principle that the asset's current use is presumed to be its highest and best use unless rebutted under the ED's proposed criteria would also be applicable to the disclosure requirement in AASB 13 paragraph 93(i). That is, the Board was advised of concern that the relief from having to search for nebulous possible higher and better uses of an asset might be negated if that relief does not apply to the requirements of paragraph 93(i) of AASB 13.

BC57 The Board concluded that disclosures under paragraph 93(i) of AASB 13 would not be required where the specific criteria for identifying a higher and better alternative use of an asset in paragraphs Aus29.1 and Aus29.2 are not satisfied. For the avoidance of doubt, the Board decided to include paragraph Aus93.2 to make this explicit.

Physically possible use

BC58 As stated in AASB 13 paragraph 22, fair value measurement of an asset is based on the assumptions that market participants would use when pricing the asset. Specifically, when the presumption that an asset's current use is its highest and best use is rebutted, to identify the highest and best use of an asset, an entity takes into account the use of the asset that is physically possible, legally permissible and financially feasible.

BC59 Stakeholders requested guidance regarding whether, and if so how, physical constraints should be considered when measuring an asset's fair value. These physical constraints can be:

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

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

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

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

These physical constraints are discussed in paragraphs BC60–BC64.

Naturally occurring physical constraints

BC60 The Board concluded that a naturally occurring physical constraint leading to an inability in practice (rather than hypothetically) to replace or relocate the asset, such as a marine park, does not of itself preclude measuring the asset at fair value because a fair value measurement assumes a hypothetical transaction.

BC61 However, for some marine parks and old growth forests there might be insufficient market data available to enable reliable estimates of the asset's fair value. The Board noted that AASB 116 paragraph 31 specifies that for an asset to be subsequently measured at a revalued amount, the fair value of the asset must be able to be measured reliably.

Physical constraints resulting from the entity's activities

BC62 The Board noted that some activities of the entity, such as using a parcel of land as a garbage tip, affect the physical characteristics of the asset that market participants would take into account when pricing the asset (eg using land as a garbage tip would limit the physically possible use of the land, as referred to in AASB 13 paragraph 28(a)).

BC63 In the case of cemetery land, even if the land were not legally restricted to being used only as a cemetery, the number of plots used for interred human remains would affect the cash-generating ability of the cemetery land because it reduces the number of remaining plots that a market participant could sell. This would be considered in measuring the fair value of cemetery land by reference, directly or indirectly, to the land's ability to generate net cash inflows or income.

BC64 The Board considered that any specific guidance regarding how physical constraints should be considered in estimating the fair value of an asset does not belong in principles-based Australian Accounting Standards.

Legally permissible use

BC65 Paragraph IE29 of the IASB's Illustrative Examples accompanying IFRS 13 (which can be accessed via the AASB's website) provides the following example of legally permissible uses of a non-financial asset:

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

BC66 Consistent with the IASB's analysis in the illustrative example quoted in paragraph BC65, the Board noted that the fair value measurement of an asset:

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

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

Prohibitions on sale

BC67 AASB 13 paragraph 28(b) is silent regarding whether prohibitions on the sale of an asset are to be considered in identifying an asset's highest and best use; that paragraph only specifies that certain restrictions on the *use* of asset should be taken into account when identifying an asset's highest and best use. Some stakeholders requested guidance on the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows that the entity is prohibited from selling, and how that prohibition should be taken into account in measuring the asset's fair value.

BC68 The Board noted that the fair value of an asset is based on a hypothetical sale transaction, notwithstanding any prohibition on the asset's sale. The restrictions taken into account when determining an asset's highest and best use are those that transfer upon the asset's sale to the hypothetical market participant. Therefore, a prohibition on sale of such an asset is not a factor in the determination of its highest and best use, and consequently should be disregarded when measuring the asset's fair value.

Legal restrictions on an asset's use

BC69 Some stakeholders requested guidance regarding restrictions relating to caveats attached to land, such as where biodiversity rights have been sold through a biodiversity scheme and the land cannot be used for another purpose. The Board considered that if the caveats would remain attached to the land upon its sale to a market participant, such caveats should be considered in identifying the asset's highest and best use.

'Implied restrictions' on an asset's use

BC70 Some stakeholders have informed the Board that sometimes a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, although not subject to any legal restrictions, is subject to an 'implied restriction' limiting the asset's use to its current use – that is, where there is no legal restriction imposed on the asset but, because of social or political expectations or other factors, the not-for-profit public sector entity holding the asset would be unable to use the asset for an alternative use.

BC71 Those stakeholders consider that those assets with implied restrictions would never be sold by the entity holding them because of the legal mandates applying generally to the not-for-profit public sector entity. Therefore, they consider that the entity can only use those assets for their current use. They argued that implied restrictions over the use of an asset should be treated as substantially the same as legal restrictions referred to in AASB 13 paragraph 28(b) in identifying the highest and best use of the asset when measuring the asset's fair value.

BC72 The Board decided that the general principles in AASB 13, as described in paragraph BC66, are sufficient in determining the highest and best use of an asset subject to implied restrictions – that is, the highest and best use of an asset takes into account physical characteristics of the asset that market participants would take into account when pricing the asset, and legal restrictions on use that would be transferred to market participants in a hypothetical sale transaction. In addition, the Board noted that the strict criteria in paragraphs Aus29.1 and Aus29.2 for measuring an asset based on an alternative use to its current use should restrict the circumstances in which the fair value of an asset with implied restrictions would be measured based on an alternative use.

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

BC73 Consistent with the Board's view noted in paragraph BC66, if legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset not held primarily for its ability to generate net cash inflows would not be transferred to market participants, those restrictions would not be considered in fair value measurement of the asset. The Board observed that, in various cases, such legal restrictions on prices that can be charged are entity-specific restrictions (ie restrictions that are not expected to transfer to market participant buyers).

BC74 For example, a city council might provide car parking at below-market prices to provide enhanced access (and entice more visitors) to the city centre. Because a market participant buyer in a hypothetical sale of the city council's car park would not be restricted to providing car parking at below-market prices, it would price the city council's car park without regard to the discounts currently provided to patrons. Therefore, the fair value estimate of the car park should not be reduced (compared with the value determined for a for-profit entity) because of a self-imposed restriction to charge below-market prices for the use of car spaces.

Financially feasible use (paragraph Aus28.1)

BC75 The Board was also asked to clarify the application of 'financially feasible use' in AASB 13 paragraph 28(c) to non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, because those assets are not held primarily to produce an investment return. AASB 13 paragraph 28(c) refers to an asset's use that "generates adequate income or cash flows … to produce an investment return …".

BC76 The Board considered that modifying AASB 13 is necessary to avoid the risk that AASB 13 paragraph 28(c) is interpreted to preclude measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows at an amount exceeding the present value of cash inflows generated directly by the asset. Such an interpretation could result in measurements that do not reflect faithfully the service potential embodied in those assets for which market participants would be prepared to pay in a hypothetical sale transaction. The Board noted that for many assets not held primarily for their ability to generate net cash inflows, their fair value would be measured at current replacement cost (under the cost approach), and although these assets often generate considerable cash inflows through 'indirect' sources, such as appropriations and grants, these cash inflows typically would not be included in assessments of 'investment returns' such as the cash inflows used in applying the income approach.

BC77 The Board noted that respondents to ED 320 strongly supported the Board's proposed clarification, and decided to add paragraph Aus28.1 to AASB 13.

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

BC78 A group of stakeholders asked the Board to clarify whether, in relation to land and improvements of a not-for-profit public sector entity not held primarily to generate net cash inflows, the fair value of improvements on land should be measured at nil if it has been concluded that the highest and best use of the land used jointly with improvements is different from its current use (to provide services to the community) and the highest and best use assumes the existing improvements on the land would be demolished. The Board noted that:

(a) the IASB considered this issue in the context of for-profit entities when developing IFRS 13 (see paragraphs BC80 and BC81); however,

(b) the IFRS Interpretations Committee issued an Agenda Decision *Valuation of biological assets using a residual method* in March 2013. The Agenda Decision concerned biological assets that are physically attached to land, which have no separate market value and are measured at fair value using a residual method. The Committee noted that "IFRS 13 does not explicitly address the accounting implications if those circumstances arise and the fair value measurement of the asset based on its highest and best use assumes that other assets in the group need to be converted or destroyed." The Committee also noted that this issue might affect the accounting for assets in scope of other Standards than IAS 41 *Agriculture*, and for these reasons decided not to undertake a project to address this issue; and

(c) this issue is not specific to not-for-profit entities.

BC79 Therefore, the Board decided not to develop implementation guidance on this issue. In addition, the Board noted that, since receiving the stakeholder group's request for guidance noted in paragraph BC78, the Board developed criteria in paragraphs Aus29.1 and Aus29.2 that must be satisfied before identifying a higher and better use of a non-financial asset not held primarily for its ability to generate net cash inflows – specifically, in various circumstances, it might nullify the premise of the question that the assets' current use is not their highest and best use. For an alternative feasible use of land and buildings currently used for a community purpose to be identified as the highest and best use of those assets (thus potentially imply that the buildings have a fair value of nil), it would be necessary to meet the criteria in paragraphs Aus29.1 and Aus29.2 for concluding that an asset's current use is not its highest and best use. If those criteria are met, the discussion in paragraphs BC80–BC84 would be relevant.

BC80 In relation to this issue generally, paragraphs BC72 and BC73 of the IASB's Basis for Conclusions for IFRS 13 use an example of a factory. Paragraph BC72 states that "The IASB concluded when developing the exposure draft" [of IFRS 13] "that measuring the factory at nil would not provide useful information when an entity is using that factory in its operations. In particular, users would want to see depreciation on that factory so that they could assess the economic resources consumed in generating cash flows from its operation." Prior to finalising IFRS 13, the IASB had exposed a proposed requirement for an entity to separate the fair value of the asset group into its current use and fair value components.

BC81 However, after considering responses from its stakeholders that preparing separate valuations for each asset in the group of assets would be costly, the IASB noted in paragraph BC73 that "… when an entity uses a non-financial asset in a way that differs from its highest and best use (and that asset is measured at fair value), the entity must simply disclose that fact and why the asset is being used in a manner that differs from its highest and best use." That disclosure requirement is stated in IFRS 13 paragraph 93(i).

BC82 Therefore, when the highest and best use of land and improvements collectively within a group of assets of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is different from their current use by the entity (after applying the requirement in paragraphs Aus29.1 and Aus29.2 that an alternative use would be identified as highest and best use if it is highly probable that the asset will be sold, distributed or used for an alternative purpose), the entity would nonetheless conform to the general principle that each asset's fair value is based on its highest and best use (which may mean that the factory in the IASB's example would be measured at nil), but include a disclosure note explaining why the asset is being used in a manner that differs from its highest and best use, in accordance with AASB 13 paragraph 93(i).

BC83 The Board noted that AASB 13 paragraph 31(a)(iii) states that: "assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used." In relation to the question from the group of stakeholders noted in paragraph BC78, the Board noted a view that, consistent with AASB 13 paragraph 31(a)(iii), it would be inappropriate for land and its improvements to have two different highest and best use assumptions if they are used in combination to maximise value to market participants.

BC84 The Board also noted that paragraph 17 of AASB 101 *Presentation of Financial Statements* states that to achieve a fair presentation of financial statements, an entity is required to "… provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance". The Board noted a view that, if an entity considers the current value of those improvements based on their current use and periodic depreciation are important to users of financial statements, it would consider whether it should disclose this information to comply with AASB 101 paragraph 17.

Market participant assumptions about a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs F2–F7)

BC85 Consistent with IFRS 13, when measuring the fair value of an asset under AASB 13, the objective is to estimate an exit price from the perspective of a market participant for the asset at the measurement date. Therefore, fair value assumes that a market participant's assumptions when pricing an asset are identifiable.

BC86 Some stakeholders expressed the view that, in some cases, a market participant for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is not readily identifiable. This is because the services provided by such an asset sometimes are unique; and therefore, they argued that:

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

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

BC87 In this respect, the Board noted that AASB 13 paragraph 23 states that an entity need not identify specific market participants, reflecting the focus of AASB 13 paragraph 22 on the *assumptions* that market participants would use when pricing the asset. An entity estimates the pricing assumptions that other market participants (ie market participants other than the holder of the asset) would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

BC88 In light of the stakeholder comment that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are unique to the holder of the asset and another identifiable market participant for the asset would be unlikely to exist (ie the entity would be unlikely to find observable inputs for measuring the fair value of such unique assets), the Board considered that the holder of those assets would need to develop at least some unobservable inputs in order to measure the fair value of those assets.

BC89 AASB 13 paragraph 89 (in relation to developing unobservable inputs) states that:

> "An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, **an entity may begin with its own data**, but it shall **adjust those data if reasonably available information indicates that other market participants would use different data** or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. **Unobservable inputs developed in**

the manner described above are considered market participant assumptions and meet the objective of a fair value measurement." [emphasis added]

BC90 AASB 13 paragraph 89 permits the use of an entity's own data in developing unobservable inputs. In relation to applying the principle noted in paragraph BC87, the Board decided to add implementation guidance to AASB 13 clarifying paragraph 89 by:

(a) re-expressing the requirements of that paragraph, so that an entity's own assumptions are required to be used at a starting point if some relevant information about other market participant assumptions needed to estimate the fair value of the asset is not reasonably available;

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

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

BC91 Adding paragraphs F5–F7 to AASB 13 is justified in accordance with paragraphs 24(a)(iii) and 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*, to reduce the potential for confusion regarding when the search for assumptions of other market participants ends, and in turn reduce the cost and effort required to identify which market participant assumptions to use in measuring the fair value of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. This is because, unlike paragraph 89 of AASB 13, paragraphs F5 and F6 state that:

(a) if some data of other market participants to measure the fair value of an asset are not observable, the entity uses its own assumptions as a starting point and adjusts them to the extent that reasonably available information indicates that other market participants would use different data; and

(b) if no relevant information about the assumptions of other market participants is reasonably available, the entity would use its own data to estimate the fair value of the asset without the need to incur exhaustive efforts to identify other market participant data.

BC92 In addition, paragraphs F5–F7 should be clearer and more straight forward to apply than paragraph 89 of AASB 13 alone, by treating the reasonable availability of other market participant data as a criterion for amending the entity's own assumptions, thus stipulating a process with two distinct steps. Paragraph 89 of AASB 13 refers to an entity needing to take into account all information about market participant assumptions that is reasonably available, without indicating the sequence in which that information would be taken into account if an entity uses its own data as part of estimating an asset's fair value.

BC93 The Board noted that respondents to ED 320 generally supported the Board's proposed guidance, and decided to confirm that guidance with some editing for greater clarity.

BC94 The Board observed that some stakeholders commented that infrastructure (eg roads, drainage and sewerage works), parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, and community facilities (eg toilet blocks) are typical assets of which information about other market participant assumptions often would neither be reasonably available nor indicate that those assumptions differ from the entity's own assumptions. However, the Board concluded it will depend on the facts and circumstances of each non-financial asset whether it exhibits neither of these characteristics.

BC95 The Board also considered a request from ED respondents for clarification of whether the proposed requirement to measure an asset's fair value using the entity's own assumptions as a starting point would apply on a whole-of-asset basis or on a per-input basis to a fair value estimate. The Board decided to clarify in paragraph F7 that, when some inputs to a fair value estimate are observable market data and other inputs are unobservable, unobservable inputs would only be used for part of the asset's fair value estimate. Paragraph F7 provides an example of a self-constructed specialised facility, the land component of which has comparable land with an observable market price. If entity-specific data are needed to measure the fair value of some or all of the improvements on that land, those entity-specific data would be included in the fair value estimate for the facility together with observable data about market participant assumptions for other components of the facility.

Specialised asset considerations

BC96 Since most stakeholders' requests for guidance on fair value measurement pertain to non-financial assets that either have limited market inputs, or are specialised, or both, the Board considered whether to provide guidance on identifying the market participant assumptions to use when measuring specialised assets only, rather than providing guidance more broadly on all non-financial assets not held primarily for their ability to generate net cash inflows.

BC97 The Board decided not to provide guidance limited to specialised assets because:

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

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

Other considerations

BC98 The Board considered, but rejected, providing guidance on market participant assumptions based on whether a market participant other than the holder of the asset subject to measurement (the subject asset) is readily identifiable, and on identifying the entity likely to be the highest bidder for the subject asset in a hypothetical sale.

BC99 The Board made this decision after considering comments received from stakeholders in targeted outreach that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are not sold regularly and may not have market participants other than the holder of the asset. Two main concerns were raised by stakeholders regarding the approach described in paragraph BC98, namely that:

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

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

BC100 The Board concluded that re-expressing the requirements of AASB 13 paragraph 89 in the manner described in paragraphs F5–F7 would address these two key concerns raised by stakeholders.

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

BC101 This issue relates to an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows and measured under the cost approach (eg a public school or public hospital). This issue mainly concerns the fair value measurement of real property.

BC102 The Board was asked to clarify whether the location of the real property being valued should necessarily be the property's existing location, particularly in view of the principle that an asset's current replacement cost reflects replacement in the most economical manner. For example, if a facility could deliver its services equally well in a nearby location with cheaper land, the Board was asked whether it be assumed that "the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility" (as referred to in AASB 13 paragraph B9) reflects the price of the facility in the cheaper location.

BC103 For the reasons in paragraph BC117, a fair value estimate is based on an assumed hypothetical exchange transaction by considering data about a reference asset. Some stakeholders argued that the facility's fair value estimate should reflect the price of suitable property in a cheaper feasible location (the arguably suitable reference property) because a market participant buyer would not be willing to pay for an asset at a more expensive location, if the facility could deliver its services equally well in a nearby location with cheaper land. They argued that applying the generally accepted principle that an asset's current replacement cost is measured on an optimised basis typically by reference to the price of a modern equivalent asset, the modern equivalent asset would be a nearby asset in a cheaper location.

BC104 These stakeholders argued that the market value premium of property in its existing location over a suitable alternative location is a commercial element superfluous to the entity's not-for-profit (service delivery) objectives. They note that their view is consistent with the following text of The Royal Institution of Chartered

Surveyors' Guidance Note *Depreciated replacement cost method of valuation for financial reporting* (November 2018):[1]

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

BC105 In contrast, some other stakeholders argued that the current replacement cost of real property should always reflect the property's existing location, rather than the price of land in a cheaper feasible site. This is because the land's characteristics include its location, and the price premium for the existing site (compared with a cheaper feasible site) could be realised through sale and reinvested in other assets used to provide services. For example, the Application Guidance included in the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17 *Property, Plant and Equipment* states that:

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

BC106 Similarly, some stakeholders argued that, from the perspective of market participants, the property in a more expensive location provides superior services. For example, an office space in a central business district location provides greater service capacity than office space in an inner suburb by having greater proximity to stakeholders and urban infrastructure and by assisting the entity to attract and retain staff. These stakeholders are also of the view that if the property's service capacity can be relocated to another location, then the highest and best use of the current property is not limited to its existing use; and therefore, should be valued at its current location, reflecting its highest and best use.

BC107 Having regard to these conflicting views, the Board noted that it could theoretically be argued that the current replacement cost of an item of real property of a not-for-profit public sector entity should be measured as follows:

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

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

   (i) the price a market participant would be prepared to pay to remove the improvements and then sell the property as a vacant site for an alternative use – reflecting the property's existing location. This is because an asset's fair value can never be less than the price for which that asset could be sold at the measurement date (excluding transaction costs); and

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

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

participant would build a modern equivalent property in an alternative site, if it would be cheaper than purchasing the asset in its existing location.

BC108 However, on further deliberation, the Board observed that the approach described in paragraph BC107 would have the following disadvantages:

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

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

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

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

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

BC109 In light of the concerns in paragraph BC108, the Board concluded that the current replacement cost of an asset, including real property, of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows should be measured by assuming the asset is replaced in its existing location, even if it would be feasible to relocate the asset to a cheaper location. The Board noted that respondents to ED 320 strongly supported the Board's view, and decided to add paragraph F11(a) in Appendix F of AASB 13.

Nature of costs included in current replacement cost (paragraphs F8–F15)

BC110 The Board was asked to clarify which costs should be included in the current replacement cost of an asset held by a not-for-profit public sector entity when applying the cost approach under AASB 13 paragraphs B8–B9, particularly where such an asset is constructed by or on behalf of the entity (ie not replaced in a single transaction). Specifically, stakeholders requested the Board to clarify whether the following costs should (among other costs) be included in the current replacement cost of the asset subject to measurement (the subject asset):

(a) costs of parts of an asset not expected to actually be replaced in the future, because they are not expected to wear out, but that would need to be incurred in a hypothetical acquisition or construction of the subject asset by a market participant buyer;

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

(c) intrinsically linked disruption costs, including costs of restoring another entity's asset that would be disrupted in a hypothetical replacement of the subject asset (the nature of disruption costs is explained in paragraph BC139).

BC111 Stakeholders also requested the Board to clarify, when identifying the component costs to include in an asset's current replacement cost, whether it should always be assumed that the asset would be replaced in the most economical manner, even if the entity would, in its ordinary course of operations, be required to incur additional costs.

BC112 The majority of respondents to ED 320 expressed in-principle support for most of the proposed implementation guidance on the nature of the costs to include in the current replacement cost of an asset, but also expressed concerns about the practical challenges of applying that proposed guidance. The Board considered the feedback and revised the guidance to address those concerns.

BC113 In particular, the Board observed that respondents' concerns about the difficulty of identifying and measuring some costs are mainly related to assets within the scope of the guidance in paragraph 89 of AASB 13 – when the market selling price of a comparable asset and at least some other market participant data are not observable. The Board added paragraph F5 to require an entity to use its own assumptions as a starting point and adjust them only to the extent that reasonably available information indicates that other market participants would use different data. In addition, the Board decided to provide a practical expedient in paragraph F14 whereby an entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraph BC110, provided that the entity includes all such costs for which data are reasonably available.

BC114 The Board also considered the feedback that identifying an asset's current replacement cost as including the costs referred to in paragraph BC110 might require an entity to recognise and measure separately some assets at a considerably more disaggregated level, resulting in increased cost and effort. For example, concerns were expressed that greater disaggregation might become necessary for costs to restore assets of other entities disturbed upon replacement of the subject asset, because those restoration costs would vary considerably according to location-specific factors. The Board observed that the implementation guidance on the application of the cost approach does not preclude the use of unit rates or standard costing methodologies that approximate the total amounts of individual assets, particularly in applying the concept of materiality. Similarly, the implementation guidance does not mandate the unit of account for assets measured at fair value by applying the cost approach.

The overarching principle

BC115 The definition of fair value in AASB 13 paragraph 9 refers to the price that would be received to *sell* an asset (ie exit price). However, when the best evidence of a subject asset's fair value (maximising the use of relevant observable inputs) is not data about that asset's selling price or net cash inflows from use (and therefore the cost approach is applied), the asset's fair value is derived by regard to the asset's market *buying price* (often the sum of a number of purchase prices for the asset's parts). In relation to applying the cost approach, paragraph B9 of AASB 13 states that: "From the perspective of a 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. That is because 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."

BC116 In this regard, the price a market participant buyer would be prepared to pay for a subject asset is estimated by reflecting the fact that the market participant buyer presently does not possess the subject asset and needs to acquire it in its entirety. The Board concluded that, to estimate this amount, an entity would include all necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date. This is because a market participant buyer of the subject asset would need to incur all those costs if it acquired the subject asset at the measurement date, whether that buyer hypothetically acquires the subject asset from the entity or constructs a substitute asset itself.

BC117 Because the subject asset is held by the reporting entity at the measurement date, an actual sale of the subject asset by the reporting entity to a market participant buyer did not occur on the measurement date. Consequently, as noted in IFRS 13 paragraph BC30, the definition of fair value assumes a hypothetical exchange transaction. Assuming a hypothetical acquisition or construction of a substitute asset by the market participant buyer requires the consideration of data about a reference asset. Therefore, an estimate of an asset's current replacement cost includes all necessary costs intrinsically linked to hypothetically acquiring or constructing a *reference asset* at the measurement date The process of identifying and using data about reference assets, while maximising the use of relevant observable inputs and minimising the use of unobservable inputs, is discussed in paragraphs BC119–BC123.

BC118 ED 320 proposed the concept of "assuming the subject asset presently does not exist" as the overarching principle of the cost approach. The Board proposed that assumption as 'short hand' for the principle that the market participant buyer presently does not possess the subject asset and needs to acquire that asset in its entirety. However, a few respondents commented that the concept that the subject asset presently does not exist conflicts with the proposed requirements to include certain asset-specific costs in current replacement cost. The Board decided not to state an overarching principle for the cost approach in the implementation guidance because paragraphs B8 and B9 clearly state that the cost approach reflects the amount that would be required currently to replace the service capacity of an asset, which requires all necessary costs intrinsically linked to the hypothetical acquisition or replacement of a reference asset to be included in the subject asset's current replacement cost.

Reference assets

BC119 The Board noted that, consistent with International Valuation Standard IVS 105 *Valuation Approaches and Methods* (effective 31 January 2022), measuring the fair value of an asset applying the cost approach generally requires an entity to:

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

(b) adjust that estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset.

BC120 IVS 105 mentions that a reference asset could be a modern equivalent asset or a replica asset. Paragraph 70.5 of IVS 105 describes a modern equivalent asset as an asset "… that provides similar function and equivalent utility to the asset being valued, but which is of a current design and constructed or made using current cost-effective materials and techniques."

BC121 Paragraph 70.6 of IVS 105 states that using the reproduction cost method (ie the reference asset is a replica of the subject asset) to measure the value of the subject asset is appropriate in circumstances such as the following:

(a) the cost of a modern equivalent asset is greater than the cost of recreating a replica of the subject asset; or

(b) the utility offered by the subject asset could only be provided by a replica rather than a modern equivalent.

BC122 Some respondents to ED 320 argued that the implementation guidance should stipulate that a modern equivalent asset should be used as a reference asset only where a replica of the subject asset is unavailable. The Board disagreed with that suggestion because:

(a) if the current service capacity of an asset can be replaced more economically by a modern equivalent asset, it would be unlikely that a market participant buyer would be willing to pay the higher cost of a replica; and

(b) it would make AASB 13 more restrictive than IVS 105 and thus provide guidance on matters relating to detailed valuation assessments, which does not belong within the scope of an Australian Accounting Standard.

BC123 A few ED respondents argued that, for heritage assets held for their heritage significance, their replacement cost should be based on replication of the original heritage design but using modern cost-effective materials and processes (which are aspects of a modern equivalent asset). The Board agreed with that argument, and added implementation guidance to that effect in paragraph F15.

Costs of parts of assets that will not actually require replacement

BC124 The Board was requested to provide guidance on whether an asset's current replacement cost should exclude costs of any parts of the asset that will not actually require replacement in the future because their service capacity does not expire over time (ie 'once-only costs'). This issue has been the subject of debate and diverse practice (for example, the current replacement cost of some roads has been estimated by excluding the cost of 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).

BC125 The Board concluded it would be inappropriate to exclude any costs from an estimate of an asset's current replacement cost on the grounds that they relate to parts of an asset that are not expected to actually be replaced in the future. For the reasons in paragraphs BC115–BC117, an estimate of an asset's current replacement cost should include all necessary costs intrinsically linked to hypothetically acquiring or constructing a reference asset at the measurement date, reflecting that the hypothetical acquisition or construction costs are incurred by a market participant buyer that does not possess the subject asset at the measurement date.

BC126 Current replacement cost assumes hypothetical replacement or reconstruction of a reference asset, and is not limited to costs of replacements the entity expects to incur in the future (which is a matter of budgeting rather than measurement of existing resources). To exclude any costs from an estimate of an asset's current replacement cost on the grounds that they relate to parts of an asset that are not expected to actually be replaced in the future would imply that the fair value of an asset measured under the cost approach would be zero if, at the measurement date, the holder of the asset expects the asset neither to be replaced at the end of its useful life nor to have components replaced during its remaining useful life.

BC127 One respondent to ED 320 and some other stakeholders requested clarification of the 'starting point' for identifying once-only costs. For example, they commented that the 'starting point' that should be the focus of measuring the current replacement cost of parts of an asset could be the conditions prevailing at the site of the subject asset when it was initially acquired or constructed (but with the resulting costs measured using prices current at the measurement date), a vacant site with all site preparation works completed, or some other as-yet undefined point.

BC128 The Board considers that this question has conceptual and practical dimensions. From a conceptual viewpoint, AASB 13 paragraphs B8–B9 state that the cost approach to measuring an asset's fair value reflects the amount that would be required *currently* to replace the asset's service capacity. Therefore, in concept, the 'starting point' for considering the costs to include in an asset's current replacement cost is the current conditions (including market conditions and current operating environment) of the subject asset, estimated using a reference asset as input.

BC129 From a practical viewpoint, the entity might have limited information about some of the costs required currently to replace the service capacity of a reference asset. Although some costs to acquire or construct parts of an asset often have industry-wide data available to assist their estimation (eg costs of drainage pipes), some other parts of assets have costs that tend to be site-specific, and it may be necessary to use historical data retained by the holder of the subject asset. This can present practical difficulties, especially for costs of any parts that have not been incurred in recent years.

BC130 The Board concluded that an entity should not need to undertake exhaustive efforts to obtain information about the costs composing an asset's current replacement cost; however, an entity includes all such costs for which data are reasonably available (see paragraph F14). That is, under paragraph F14, if data about certain costs of some parts of an asset are not reasonably available, those costs would be omitted from an estimate of the subject asset's current replacement cost. However, those costs are not omitted simply because they relate to parts of an asset that are not expected to actually be replaced in the future.

Site preparation costs

BC131 Entities would need to apply judgement in the circumstances of the subject asset to determine the necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date. For an asset fixed to a parcel of land, this would include whether it would be necessary for the market participant to incur site preparation costs in order to hypothetically construct a reference asset at the subject asset's location.

BC132 For example, to measure the current replacement cost of a building, an entity would consider whether a market participant buyer would be able to acquire a vacant site in the area surrounding the existing location. If suitable vacant sites are available, market participants would be unlikely to pay for the current cost to demolish existing structures on the site (and, therefore, it would be unlikely that such a cost would be considered 'necessarily incurred'). Similarly, if market participants are able to acquire a suitable parcel of land with an existing structure that they could modify as necessary to create a modern equivalent of the subject asset, it would be unnecessary to remove and dispose of existing structures on the reference parcel of land.

BC133 The costs included in an asset's current replacement cost, as a measure of the amount a market participant buyer would be prepared to pay for the asset, represent the costs avoided by a market participant buyer as a result of the entity possessing the service capacity embodied in the subject asset. Consistent with the related comment in AASB 13 paragraph B9, the market participant buyer is prepared to pay the current amount of those costs avoided, and no more. For example, if:

(a) instead of acquiring the subject asset, a market participant buyer would have no choice but to incur costs to remove and dispose of unwanted existing structures on land as part of the costs to construct an asset with service capacity equivalent to that of the subject asset (because of a lack of suitable vacant sites at the measurement date); and

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

those costs to remove and dispose of unwanted existing structures on land would be included in the subject asset's current replacement cost.

BC134 Where the conditions in paragraphs BC133(a) and (b) are satisfied, the costs to remove and dispose of unwanted existing structures on land would be those of the typical market participant buyer. However, in accordance with paragraphs F5 and F14, in the absence of reasonably available observable data about the costs saved by the market participant buyer, the entity would use its own assumptions about the removal costs it would incur if, hypothetically, those unwanted structures existed.

BC135 Some ED respondents commented that the fair value of the land on which the subject asset is fixed would, in some cases, reflect the fact that it is fit-for-purpose for the subject asset; and therefore, any hypothetical site preparation costs should be excluded from the estimated current replacement cost of fixed improvements on that land to avoid double-counting the site preparation costs. The Board included guidance on this issue in paragraph F12(c).

BC136 Some stakeholders commented that the treatment of costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct a reference asset at the measurement date should be consistent with the treatment of costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located (AASB 116 paragraph 16 identifies this latter type of costs as part of the cost of an item of property, plant and equipment). Those stakeholders commented that if there is no present obligation for an entity to incur costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct the subject asset at the measurement date, such costs should not be included in an asset's current replacement cost. Some other stakeholders asked for clarification of the relationship between those costs and the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located.

BC137 The Board observed that, in contrast with costs to remove and dispose of unwanted existing structures on land, the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located are end-of-economic-life costs. Those latter costs would not merit inclusion in the asset's current replacement cost because the market participant buyer of the subject asset logically would not pay for those costs, which in turn is because possessing the subject asset would not save the market participant buyer from having to incur those end-of-economic-life costs.

BC138 However, the Board also observed that Illustrative Example 2 accompanying AASB Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* states that, if an asset's valuation does not include an amount for these end-of-economic-life costs for which the entity has recognised a provision, the carrying amount of the asset will need to be adjusted by adding back an appropriate amount for the provision (Interpretation 1 paragraph IE7(b)). The IFRS Interpretation Committee's Basis for Conclusions on the IFRS Interpretation adopted as AASB Interpretation 1 states that the provision is accounted for separately from the valuation of the asset to ensure it is not counted twice (paragraph BC25(a)).

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

BC139 The Board was asked to clarify whether the subject asset's current replacement cost should include the cost to restore another entity's asset that would be disrupted during the hypothetical construction of the subject asset (eg drainage works of another entity disrupted when replacing a road). The Board decided to develop proposed guidance on such restoration costs and other disruption costs arising upon the hypothetical construction of the subject asset; those costs are collectively termed 'disruption costs' in paragraph F12 and this section of the Basis for Conclusions. Examples of disruption costs other than costs of restoring another entity's assets are costs of directing and diverting traffic (including the hire of safety barriers) and costs of employing safety officers.

BC140 The key principle underpinning the inclusion of disruption costs (including, but not limited to, costs to restore another entity's assets that would be disrupted during the hypothetical construction of the subject asset) in the current replacement cost of a subject asset is that, as discussed in paragraph BC116, to reflect the pricing assumptions of market participants, a subject asset's current replacement cost includes all necessary costs intrinsically linked to acquiring or constructing that asset at the measurement date.

BC141 The Board considered the following comments expressed by some stakeholders that it would be inappropriate to include the cost to restore another entity's asset in the current replacement cost of an asset held by the entity:

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

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

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

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

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

BC142 In relation to the concern noted in paragraph BC141(a), the Board regards such restoration costs as costs of obtaining access to the service capacity embodied in the entity's subject asset. The Board noted that such costs restore, rather than enhance, the disrupted asset and, accordingly, are confined to the consequences of acquiring or replacing the entity's subject asset.

BC143 In relation to the concern noted in paragraph BC141(b) about recognition of an increase in an asset's fair value without the entity incurring a related cost (and therefore a gain being recognised), the Board noted that these increases are examples of various increases in the market buying prices of components of assets that continue to be held by the entity and do not involve a related cost to the entity. The Board considered that a market participant would be willing to pay more for an asset due to the change in the asset's operating environment, despite the asset's service capacity to produce outputs not having improved. This is because all costs to restore another entity's asset would necessarily be incurred by a market participant if it were to acquire or construct the subject asset at the measurement date. Those additional restoration costs are necessarily incurred to obtain access to the services the subject asset is expected to generate. Similarly, a market participant would consider the costs currently avoided by possessing the subject asset: these costs are not limited to those already incurred by the entity or to restoration costs that would have been incurred to initially acquire or construct the asset.

BC144 The Board agrees with the concern noted in paragraph BC141(c) that the consolidated financial statements of the group to which the entity belongs would be overstated if both the disrupted asset and the subject asset are measured at their current replacement cost and included in the consolidated financial statements. Therefore, the Board decided that the current replacement cost of the subject asset should exclude any costs that hypothetically would be incurred to restore assets of an entity within the same consolidated group as the holder of the subject asset.

BC145 In reaching that decision noted in paragraph BC144 about the double-counting issue described in paragraph BC141(c), the Board considered whether, instead, it would be appropriate to exclude such restoration costs from current replacement cost, on the grounds of simplicity, for all non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. However, the Board decided against this approach because feedback from some stakeholders (in particular, local governments) supported including restoration costs for another entity's assets – consistent with local governments not being identified as entities included in a group of entities that prepares consolidated financial statements.

BC146 The Board acknowledged that the proposed exclusion of such restoration costs for assets of entities within the consolidated group to which the holder of the subject asset belongs would depart from the conceptual principle that an individual entity's assets are accounted for by reflecting the entity's perspective (rather than the perspective of the group). The Board considered that a more conceptual variation of the approach noted in paragraph BC144 would be to provide guidance that such restoration costs are included in an individual entity's financial statements where the entity is part of a group of entities that prepares consolidated financial statements, but eliminated on consolidation. However, in view of the cost involved in tracking such restoration costs at each measurement date, only to omit those restoration costs from the consolidated financial statements for the group, the Board considers that the costs of applying that more conceptual variation would be likely to outweigh the benefits of that approach.

BC147 Paragraph F12(a) does not require including in the subject asset's current replacement cost any costs to restore other assets of the same entity that would be disrupted in a hypothetical construction of the subject asset. This is because including those costs would double count them in fair value measurements of the entity's assets. If those other assets controlled by the entity are measured under the cost approach, their current replacement cost would include all costs of constructing them (or paying another entity to construct them) in their entirety. Therefore, the sum of the current replacement costs of each of the entity's assets should exclude any restoration costs relating to the entity's own assets.

Whether calibration is needed

BC148 In relation to including in the current replacement cost of a subject asset restoration costs of another entity's assets that were not incurred on initial acquisition of the subject asset (see paragraph BC141(b)), one stakeholder requested the Board to clarify whether including in an asset's current replacement cost any costs not yet actually incurred by the entity (and therefore resulting in a higher fair value of the asset compared with the initial capitalisation of cost) would require the application of the 'calibration' techniques referred to in AASB 13 paragraph 64. The stakeholder commented that, if calibration were required, the estimate of an asset's current replacement cost would be calibrated in such a manner that the estimate reflects actual transaction prices (ie excludes any cost components not yet incurred by the entity, such as those hypothetical costs to restore another entity's assets described above). AASB 13 paragraph 64 states that:

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

BC149 The Board considered the suggestion in paragraph BC148 and decided not to require estimates of a non-financial asset's current replacement cost to be restricted to actual transactions, as an application of AASB 13 paragraph 64. This is because:

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

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

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

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

BC150 If AASB 13 paragraph 64 were to be applied to the situation described in paragraph BC148 – measuring those assets at their actual transaction price, which would be lower than its current replacement cost that includes unavoidable hypothetical costs as explained in paragraph BC116 – it would appear to nullify the aim of AASB 116 paragraph Aus15.1. That paragraph requires not-for-profit entities to initially measure the cost of an item of property, plant and equipment at fair value in accordance with AASB 13 where the consideration for the asset is significantly less than fair value principally to enable the entity to further its objectives. The transaction price would apparently be the amount of consideration paid for the asset; by applying AASB 13 paragraph 64, fair value at initial recognition would equal the cost of acquisition (rendering AASB 116 paragraph Aus15.1 redundant).

BC151 In relation to paragraph BC149(b), the Board noted that paragraphs BC143–BC146 of the IASB's Basis for Conclusions on IFRS 13 indicate that the valuation adjustments involving calibration relate to measurement uncertainty, mainly in respect of financial assets and liabilities. The two circumstances identified in IASB paragraph BC145 that are not confined to financial assets and liabilities are where:

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

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

BC152 The Board considers that neither of the circumstances referred to in paragraph BC151 seems particularly applicable to the treatment of restoration costs yet to be incurred by the entity at the measurement date.

Piecemeal replacement

BC153 Some ED respondents commented that, in some cases, an actual replacement of an asset is undertaken in different phases (ie a part of an asset rather than the whole asset is replaced) and asked whether, when developing unobservable inputs using its own assumptions in accordance with paragraph 89, the entity should assume the asset will be replaced on a piecemeal basis or in its entirety. The Board concluded that using data of replacing an asset on a piecemeal basis might not be fully consistent with the objective of a fair value measurement under the cost approach. This is because a market participant buyer needing to acquire or construct an asset in its entirety would not need to incur additional costs that arise from replacing an existing asset on a piecemeal basis (such as security costs incurred to provide continuity of service delivery), nor would it logically be willing to pay the holder of the subject asset for incurring those additional costs.

BC154 The guidance in paragraph F14 that an entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraphs F12 and F13, provided that the entity includes all such costs for which data are reasonably available, should address concerns about practical difficulties of measuring the current cost to hypothetically replace an asset in its entirety if the asset's parts are actually replaced on a piecemeal basis. Where specific additional costs arising from piecemeal replacement are identifiable, they can readily be excluded from the estimate of the asset's current replacement cost. Where it is unclear whether some 'piecemeal costs' would differ if incurred as part of an entire replacement, when paragraph F5 applies, applying its principle to use the entity's own assumptions as a starting point and adjust them only to the extent that reasonably available information indicates that other market participants would use different data would generally mean that the entity's own costs would be used, thus overcoming the practical difficulty of estimating the cost to hypothetically replace an asset in its entirety.

The most economical manner of hypothetical replacement

BC155 Application of the cost approach assumes implicitly a hypothetical acquisition or construction of the subject asset occurs in the most economical manner. However, stakeholders informed the Board that in many cases, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs in order to maintain an adequate quality of services to the public or to adhere to unlegislated Government policies that direct or limit replacement options, eg in relation to Australian industry content or security. Where the entity or another market participant replaces an asset, and it would necessarily incur greater costs than the cheapest legally permitted costs, the more expensive costs would be those most likely to be included in the pricing assumptions of the market participant and to be incurred in the ordinary course of operations. This view was included in ED 320 and was supported by a majority of respondents.

BC156 Therefore, the Board decided to include two illustrative examples (Examples 3 and 4) illustrating that, when paragraphs F5 and F11(b) apply, the entity estimates the cost currently required for a market participant buyer to acquire or construct a reference asset by using its own assumptions as a starting point and adjusting those assumptions to the extent that reasonably available information indicates that other market participants would use different data. Where, for the reasons in paragraph BC155, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs, typically those additional costs would be included in the measurement of the asset's current replacement cost because there would not be reasonably available information indicating that other market participants would use different data. However, the treatment of such additional costs would depend on the facts and circumstances.

Finance costs

BC157 The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include finance costs, including borrowing costs, in the fair value of an asset that is not held primarily for its ability to generate net cash inflows and is measured at current replacement cost under the cost approach if it necessarily takes a substantial period of time to get ready for its intended use (ie whether the current replacement cost of such an asset should include finance costs that would be incurred during a hypothetical construction). In particular, if a private sector entity constructs an asset on behalf of the not-for-profit public sector entity, and if finance costs were to be included in the asset's current replacement cost, some stakeholders asked for guidance on whether the private sector entity's, or public sector entity's, asset-specific borrowing rate should be used in estimating the finance costs.

BC158 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of an asset is not specific to not-for-profit entities in the public or private sector. It concluded that, in light of AASB 13 not specifying the treatment of those costs for fair value measurements by for-profit entities, it would be inappropriate to mandate a particular treatment for not-for-profit entities applying AASB 13.

BC159 The International Valuation Standards Committee (IVSC) has indicated that consideration should be given to including borrowing costs and equity costs in the fair value of property, plant and equipment. IVS 105 states:

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

BC160 The Board noted that some stakeholders argue that a not-for-profit public sector entity should exclude borrowing costs from the current replacement cost of an asset if that entity elects, under AASB 123 *Borrowing Costs* paragraph Aus8.1, not to capitalise borrowing costs into the cost of qualifying assets. Some of those stakeholders argued that including borrowing costs in an asset's current replacement cost after writing them off on initial recognition of a qualifying asset would give rise to a revaluation gain that reflects inconsistent treatment of borrowing costs at different measurement dates – which they argue would not faithfully represent a change in the asset's value. The Board notes that this is a similar concern to that noted in paragraph BC141(b) regarding restoration costs included in the current replacement cost of an asset without having been incurred during the asset's initial construction, giving rise to what some stakeholders regard as an anomalous gain.

BC161 The Board considered that the accounting policy choice regarding capitalisation of borrowing costs at the asset's initial recognition under AASB 123 is irrelevant to how those costs should be treated in subsequent measurements of an asset that necessarily takes a substantial period of time to get ready for its intended use. This is because the price that market participant buyers would pay for an asset is unaffected by accounting policies adopted in respect of that asset. The recognition of initial costs and subsequent measurement are fundamentally different processes. Therefore, there should be no presumption that the treatment of borrowing costs should be consistent for both. The Board observed that AASB 13 paragraph B4 identifies a range of circumstances in which an asset's fair value at initial recognition can differ from its transaction price, indicating that items of comprehensive income can arise from differences between the transaction price reflected in initial measurement and fair value.

Which entity's borrowing rate should be used?

BC162 The Board was also asked to provide guidance to not-for-profit public sector entities about which entity's borrowing rate should be used to measure those borrowing costs, if borrowing costs were to be included in the asset's current replacement cost. Where the cost approach is used, if borrowing costs or other finance costs are included in the asset's fair value measurement, under the guidance in paragraphs F5 and F6:

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

(b) if some relevant information about market participant assumptions needed to estimate the fair value of the asset is not reasonably available, the entity's own assumptions would be used as a starting point to determine the amount of finance costs to include in the asset's current replacement cost. The entity would adjust those assumptions for any reasonably available information about any different data used by other market participants relating to borrowing and other finance costs.

BC163 However, in respect of the situation described in paragraph BC162(b), the Board observed that, in most cases in which the asset subject to measurement has specialised features, information about other market participants' finance costs (including borrowing costs) specific to constructing the subject asset is unlikely to be reasonably available because applicable finance costs would depend on the financial circumstances of the constructor of the asset. When information about other market participants' finance costs is not reasonably available, the holder of the asset would use its own assumptions in estimating the amount of any finance costs to include in the subject asset's current replacement cost (if the entity determines that finance costs should be included in that asset's current replacement cost).

BC164 One respondent to ED 320 requested the Board to clarify the factors to consider regarding whether finance costs should be included in current replacement cost measurements of fair value (but without mandating either the inclusion or exclusion of funding costs in every circumstance). Consistent with paragraph BC158, the Board decided not to provide implementation guidance on those factors; since the IASB did not specify the treatment of finance costs for fair value measurements by for-profit entities, it would be inappropriate to mandate particular factors for not-for-profit entities to consider in applying AASB 13.

Economic obsolescence (paragraphs F16–F19)

BC165 AASB 13 paragraph B9 states that obsolescence incorporated in an asset's current replacement cost includes 'external (economic) obsolescence'. Paragraph IE12(b) of IFRS 13 gives an example of economic obsolescence of a machine held for use, namely, "conditions external to the condition of the machine such as a decline in the market demand for similar machines".

BC166 An equivalent notion of economic obsolescence of an asset or a facility held by a not-for-profit public sector entity is obsolescence arising from 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 the circumstances in which a not-for-profit public sector entity should identify economic obsolescence of assets measured at fair value using the cost approach, in light of uncertainty and diverse interpretations. In particular, the Board was asked to clarify whether an entity should identify economic obsolescence of a facility that has suffered a reduction in demand for its services before a formal decision has been made to reduce the facility's physical capacity, including a plan for when that decision will be implemented.

BC167 Some stakeholders argued that an entity should not identify economic obsolescence of a facility before a formal decision has been made to reduce the facility's physical capacity because, until then, it is highly unlikely to be clear whether – and to what extent – economic obsolescence exists. The Board noted that the primary consideration in assessing when to identify economic obsolescence is whether market participants would deduct an amount for economic obsolescence from the asset's replacement cost when pricing the asset. This would depend on the entity's circumstances, and not on whether a formal decision has been made to reduce the asset's physical capacity.

BC168 In some instances, it might be clear that market participants would deduct an amount for economic obsolescence when pricing an asset, even if a formal decision has not been made. Deferring inclusion of economic obsolescence in the measurement of the asset's current replacement cost until a formal decision is made would not result in a faithful representation of the adjustment for obsolescence required by AASB 13 paragraph B9. In addition, such deferral would not result in the best estimate of the price that market participant buyers would pay for the asset, and therefore would be inconsistent with the requirement in AASB 13 paragraph 22 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset.

BC169 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).

BC170 The Board noted that part of the debate about the circumstances in which to identify economic obsolescence stemmed from perceptions that AASB 13 does not have regard to the temporary or cyclical nature of shortfalls in demand for services rendered by an asset when determining whether economic obsolescence exists. Therefore, the Board decided to clarify that surplus capacity of an asset that is necessary for stand-by or safety purposes should not be identified as economic obsolescence.

BC171 Increases in demand that eliminate an apparent, but illusory, overcapacity need not be long-term in nature. For example, a school in a mining town might presently appear to have overcapacity but require a higher service capacity than indicated by present enrolments, because its enrolments are cyclical due to peaks and troughs in mining activity. Such apparent overcapacity is similar to standby assets held by entities to cope with peaks in demand: such standby assets are not affected by economic obsolescence simply because they are presently inactive. The Board observed that this is consistent with the guidance in:

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

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

BC172 The Board was asked to provide guidance on whether, for assets measured at current replacement cost and affected by economic obsolescence (eg excess capacity) an entity is required to perform two valuations (one based on the existing capacity, and another based on the estimated required capacity) in order to estimate the gross replacement cost and related accumulated obsolescence of the asset. The Board concluded that only one valuation, based on the required capacity (eg based on a school for 100 students in the example in paragraph F18 in the implementation guidance) would be required at the measurement date. However, the Board also noted that a linear relationship should not be assumed between the extent of economic obsolescence and a reduction in demand for a facility's services. Some assets composing a facility (such as a school) might need to be replaced in full to replace the facility's service capacity. Therefore, simply adjusting the asset's value for obsolescence by the percentage reduction in demand for the facility's services would result in a value that is less than the asset's fair value. In the example presented of a school, the current replacement cost of the school would not reduce by a linear amount per student attending, due to the need to maintain certain components of the school, even as student numbers decline.

BC173 In response to requests for clarification of the proposed guidance in ED 320 or additional examples, the Board included:

(a) in the implementation guidance, an example of an asset with 'surplus capacity' necessary to cater for periods of peak demand, and clarification (in the context of the example of a school with a strong indicator of economic obsolescence) that a linear relationship should not be assumed between the extent of any economic obsolescence and a reduction in demand for a facility's services; and

(b) an illustrative example (Example 5) illustrating that operating an asset for shorter periods than physically is possible, due to the operating environment of the not-for-profit public sector entity, does not of itself indicate economic obsolescence has arisen.

Approaches to estimating the fair value of specific public sector assets

BC174 The Board was asked to provide guidance:

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

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

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

BC175 In relation to the request noted in paragraph BC174(a), the asset types on which stakeholders requested guidance include:

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

(b) land not held in freehold title;

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

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

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

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

BC176 The Board observed that for many of these types of assets, there does not appear to be a not-for-profit-specific aspect to the issue; therefore, issuing guidance for not-for-profit entities in relation to their application of AASB 13 could result in the guidance being applied by for-profit entities, potentially leading to their inadvertent non-conformity with IFRS Standards.

BC177 AASB 13 paragraph 61 requires an entity to use valuation techniques that:

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

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

BC178 A majority of stakeholders who provided input to the FVM project commented that the ability to apply judgement in the circumstances in choosing among the market approach, income approach and cost approach (or a combination of those approaches) generally works well for measuring the fair value of an asset. The Board considered this comment and formed the view that Australian Accounting Standards should not limit the application of the market approach, income approach or cost approach beyond any limits in the requirements of AASB 13 paragraph 61.

BC179 Issuing the guidance requested by some stakeholders (ie specifying the approach to apply to different types of asset) would appear to conflict with the requirements of AASB 13 paragraph 61 because it might constrain entities from using the best evidence of fair value in the circumstances. In addition, AASB 13 paragraphs 62 and 63 indicate that using a combination of the market, income and cost approaches might be appropriate for various assets. Issuing guidance favouring particular approaches for particular types of assets might be incompatible with that 'combination of approaches' guidance in AASB 13.

BC180 In relation to the request for guidance on the quantum of discounts deducted for the effects of restrictions when measuring the fair value of restricted assets using the market approach (see paragraph BC174(b)), the Board noted that, for land held by not-for-profit public sector entities, the market approach is primarily applied. The Board rejected the notion of developing guidance on the quantum of discounts in relation to land for the reasons set out in paragraphs BC200 and BC201.

BC181 Further, the Board observed that most public sector entities do not determine their own accounting policies for applying the requirements of Australian Accounting Standards, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury or Finance Department (or other authority) and the Office of Local Government in each jurisdiction. In relation to the Board's conclusion not to develop guidance beyond the scope of that in this Standard, if the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction. In effect, where AASB 13 requires the exercise of judgement regarding the appropriate valuation approach, the Treasury or Finance Department (or other authority) and/or the Office of Local Government may apply judgement on behalf of entities in its jurisdiction.

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

Original request from stakeholders in 2017

BC182 All land is subject to zoning restrictions, and some land may have an easement restriction. Stakeholders have informed the Board that many not-for-profit public sector entities are subject to public-sector-specific legal restrictions beyond the zoning and easement restrictions (such as legislation specific to public sector entities or directions from Ministers) prohibiting the entity from using the land and improvements on land for a purpose other than its current use. For example, a not-for-profit public sector entity might be subject to a legal restriction prohibiting it from using a hospital and the hospital land for a purpose other than as a hospital.

BC183 This section of the Basis for Conclusions (paragraphs BC184–BC206) discusses public-sector-specific legal restrictions that are expected to be transferred to other not-for-profit public sector market participants in a hypothetical sale transaction. Legal restrictions that would not transfer to other market participants in a hypothetical sale transaction are not considered in fair value measurement of an asset.

BC184 The Board noted that in many cases, the current zoning of the land would reflect the land's public-sector-specific legal restrictions, such as having a community zoning that restricts a parcel of land to be used for community purposes. However, there might be situations in which land is zoned for a commercial purpose, but the not-for-profit public sector entity holding the land is subject to legislation preventing that entity from using any of its non-financial assets for a commercial purpose.

BC185 Panel members and other stakeholders who responded to ITC 34 originally asked the Board to provide guidance on:

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

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

BC186 Stakeholders informed the Board that the fair value of some land subject to public-sector-specific legal restrictions and not held primarily for its ability to generate net cash inflows has been valued at a very low amount; sometimes a nominal amount (eg $1 for some restricted land). They questioned whether measuring such restricted land at such a low value appropriately reflects the service potential of the restricted land. This question was asked in the context of paragraph Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements* (applicable to not-for-profit entities), which states that 'future economic benefits' or 'service potential' can be described as 'the scarce capacity to provide benefits to the entity that use them'.

BC187 The Board did not form a view on whether measuring such restricted land at a low amount or nominal amount would reflect the capacity of the restricted land available to provide benefits to the holder of the land (or to provide services to the community). The Board is undertaking a project to adapt its *Conceptual Framework for Financial Reporting* (2019) for application by not-for-profit entities, including those in the public sector. The Board plans to consider the description of service potential in the context of an asset of a not-for-profit entity as part of that project. At this stage it is unclear whether that Board consideration would have implications for the measurement of restricted land.

Feedback from public sector stakeholders during outreach

BC188 After conducting wide-ranging outreach, including outreach on ITC 45, the Board noted feedback that there is not significant diversity in how the fair value of restricted land and improvements on restricted land not held primarily for their ability to generate net cash inflows are being measured. In this regard:

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

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

BC189 The views of these stakeholder groups are elaborated on in paragraphs BC190–BC200.

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

BC190 The minority of stakeholders mentioned in paragraph BC188(b) considered that the cost approach would be the most appropriate measurement technique for measuring the fair value of restricted land where an equivalent parcel of land subject to the same public-sector-specific legal restrictions is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. They also commented that if the cost approach is applied, those public-sector-specific legal restrictions would not reduce the fair value of such restricted land to an amount less than the price of equivalent land without those restrictions. This is because, if an equivalent restricted parcel of land is not obtainable in the marketplace, the entity would need to purchase an equivalent parcel of land without those restrictions to continue delivering services, and the existence of such a restriction does not affect the price of this purchase.

BC191 Those stakeholders reached this view because they interpreted that, when applying the IASB's views in IFRS 13 paragraphs BC78–BC79:

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

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

BC192 Further, those stakeholders considered that, because the land subject to public-sector-specific legal restrictions is not held primarily for its ability to generate net cash inflows, it would generally be inappropriate to apply the income approach as an alternative to the market approach and, consequently, the cost approach should be used to measure the fair value of such restricted land.

The majority view regarding land subject to public-sector-specific legal restrictions

BC193 The majority of stakeholders mentioned in paragraph BC188(a) expressed the view that land, including land subject to public-sector-specific legal restrictions, should generally be measured using the market approach. They disagree with the view expressed by the minority of stakeholders noted in BC190 – that the cost approach should be applied in measuring such restricted land, and the fair value of such restricted land would not be lower than the price of equivalent land without such restrictions because of the effect of public-sector-specific legal restrictions, if an equivalent restricted parcel of land is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. Under the market approach, the fair value of a parcel of land should reflect any restrictions on that land, including any public-sector-specific legal restrictions, that would transfer to market participants in a hypothetical sale transaction.

BC194 This majority of stakeholders commented that although an 'equivalent' parcel of land with the same public-sector-specific legal restrictions might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence (because public-sector-specific legal restrictions often prevent an entity from selling the land), there are market transactions for other parcels of land that are suitable reference assets. Therefore, those stakeholders consider there are more relevant observable inputs for applying the market approach, rather than the cost approach, in measuring the fair value of land subject to such restrictions.

BC195 Some of the stakeholders referred to in paragraph BC194 also commented that any improvements (eg a hospital building) on a parcel of land reduce the land's service potential. They consider that improvements on land would reduce the options the not-for-profit public sector entity holder of the land has to use the land for another purpose, unless the improvements are demolished.

The Board's decision to not provide authoritative implementation guidance

BC196 Notwithstanding the interpretation of paragraphs BC78 and BC79 of IFRS 13 in paragraphs BC191 and BC192 by a minority of stakeholders, in which they concluded that the cost approach would often be appropriate in measuring the fair value of land subject to public-sector-specific legal restrictions, the Board noted that AASB 13 paragraph 61 requires an entity to select measurement techniques:

(a) that are appropriate in the circumstances;

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

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

BC197 Therefore, the Board considered that determining appropriate measurement techniques for measuring the fair value of an asset is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards. Unless there is significant diversity in applying accounting principles in practice, there is no clear case for mandating the use of a particular valuation technique in measuring the fair value of a particular type or class of assets.

BC198 Despite the debate regarding fair value measurement of land subject to public-sector-specific legal restrictions, feedback from most stakeholders in targeted outreach and most feedback on ITC 45 indicated that, in practice, the fair value of each type or class of assets affected by this issue is being measured using a largely consistent approach – that is:

(a) for land subject to public-sector-specific legal restrictions, the market approach is used (although, as noted in paragraph BC200 below, at a more detailed level, different methods are being used to calculate the adjustments to reflect restrictions); and

(b) for improvements on such restricted land, the cost approach is generally used, and an adjustment is not deducted to reflect the effect of public-sector-specific legal restrictions because the existence of a public-sector-specific legal restriction does not affect the price that the entity would need to incur to replace the asset at the measurement date.

BC199 In addition, the Board noted that AASB 13 paragraph 11 states that a fair value measurement is for a particular asset; and, therefore, when measuring the fair value of an asset, the entity considers the characteristics of the asset if market participants would take those characteristics into account when pricing the asset at the measurement date, including the condition and location of the asset, as well as any restrictions on the sale or use of the asset. This would include consideration of any public-sector-specific legal restriction that would be transferred to a market participant.

BC200 Some stakeholders commented that there is diversity in practice regarding the amounts (eg percentages) of adjustments being deducted from the value of land to reflect public-sector-specific legal restrictions, and asked the Board to provide guidance to reduce that diversity. Further, some stakeholders informed the Board that different valuers use different methods in calculating the adjustments, for example:

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

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

BC201 Since the condition and location of every parcel of land are likely to differ, and the effect of public-sector-specific legal restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted and whether the land is urban, suburban or rural, the Board considered that it would neither be practical nor appropriate for Australian Accounting Standards to specify the amount of appropriate adjustments (eg in percentage terms) under the market approach to reflect the effect of restrictions that would transfer to market participants.

BC202 As noted in paragraph BC181, in deciding not to develop guidance specific to fair value measurement of land subject to public-sector-specific legal restrictions, the Board observed that if the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction.

Stakeholder feedback on ED 320

BC203 A majority of respondents who commented on this topic agreed with the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets, including land subject to public-sector-specific legal restrictions. However, a few respondents requested the Board to mandate the use of the cost approach in measuring the fair value, or the use of an entity-specific entry price to measure the current value, of all non-financial assets of not-for-profit public sector entities not primarily held for their ability to generate net cash inflows. The Board observed that the feedback received on ED 320 did not identify any supporting or opposing arguments that had not yet been considered by the Board in deciding that fair value should remain the sole current value measurement for non-financial assets and not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land.

BC204 In addition, a few other respondents asked the Board to elevate paragraph IE29 of the IASB's Illustrative Examples accompanying IFRS 13 (quoted in paragraph BC65) to authoritative guidance. That IASB illustrative example included a comment indicating that restrictions would only be taken into account if they transfer to the market participant buyer, and those respondents envisage that elevating the specific comment to authoritative guidance would effectively preclude the deduction of discounts for restricted land.

BC205 The Board observed that the IASB decided to include that example in supplementary supporting material rather than as part of IFRS 13. The IASB stated that its Illustrative Examples illustrate aspects of IFRS 13 but are not intended to provide interpretative guidance. Accordingly, adding such an example in the Board's implementation guidance (which will be an integral part of AASB 13) would, inappropriately, elevate the status of the IASB example above that accorded to it by the IASB. In addition, it would create a risk that readers interpret the example as a rule of thumb. This is because:

(a) the IASB's conclusion that "the restriction on the use of land" would not be taken into account in the fair value measurement of the land is drawn only after "Upon review of relevant documentation (eg legal and other), the association determines that the fiduciary responsibility to meet the donor's restriction would not be transferred to market participants if the association sold the asset"; and

(b) that example did not include consideration of the zoning of the land and the likelihood that the zoning would change as stated in paragraph 140.5 of International Valuation Standard IVS 104 *Bases of Value*.

BC206 The Board considered that financial statement preparers, auditors and valuers need to apply judgement, based on the circumstances of each asset, in determining whether a restriction imposed on an asset would transfer to market participants. Therefore, the Board decided not to add that IASB example to AASB 13.

Other measurement issues

BC207 Some stakeholders asked the Board to provide guidance regarding the following:

(a) distinguishing obsolescence from depreciation;

(b) method of depreciation;

(c) description of accumulated obsolescence;

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

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

(f) treatment of damage of an asset;

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

(h) treatment of deferred maintenance expenditure;

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

(j) curable and incurable obsolescence.

BC208 In addition, two respondents to ED 320 reiterated their requests for guidance on issues (a), (b) and (j), and on the appropriate disaggregation of parts of an asset to ensure the correct calculation of depreciation expense.

BC209 The Board noted that none of the issues in paragraphs BC207 and BC208 represent a justifiable circumstance under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require not-for-profit-specific modifications or guidance. This is because:

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

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

BC210 The Board considered that some of those issues relate to detailed valuation assessments, and specific guidance on them should not be included in Australian Accounting Standards. The Board also considered that the treatment of many of the issues would depend on facts and circumstances, and the role of principles-based Standards does not include providing detailed guidance about the various outcomes that can arise.

BC211 In addition, the Board noted that existing AASB pronouncements include guidance addressing some issues listed in paragraph BC207. These items of guidance are noted in paragraphs BC212–BC215.

Distinguishing obsolescence from depreciation

BC212 Some stakeholders asked the Board to clarify in Australian Accounting Standards that obsolescence for fair value measurement is different from depreciation. Since AASB 13 paragraph B9 specifies that obsolescence for fair value measurement under the cost approach is different from depreciation under AASB 116, the Board decided that additional guidance is not warranted. AASB 13 paragraph B9 states that: "Obsolescence … is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives)."

BC213 The Board observed that aspects in addition to the depreciation of an asset need to be considered in measuring the fair value of an asset. AASB 13 paragraph 11 specifies that fair value measurements take into account characteristics of an asset that market participants would take into account, including, for example, the condition and location of the asset, and any restrictions on the sale or use of the asset.

Method of depreciation

BC214 Regarding comments by some stakeholders that many entities are applying the straight-line depreciation method by default, the Board considers that AASB 116 addresses this issue adequately. AASB 116 paragraph 60 states that: "The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."

Description used in disclosures of accumulated obsolescence

BC215 In relation to the requirement in AASB 116 paragraph 73(d) to disclose accumulated depreciation for each class of property, plant and equipment, some stakeholders asked whether another description than 'accumulated depreciation' is permitted for disclosing the amount of accumulated obsolescence in financial statements. In accordance with the principle in paragraph 57(b) of AASB 101 *Presentation of Financial Statements* that the use of other terms, line items or subtotals in financial statements is permitted where such presentation is relevant to the understanding of the entity's financial position or financial performance, the Board considered that using a term other than 'accumulated depreciation' to describe accumulated obsolescence would not be a breach of AASB 116.

Effective date and application

Prospective application

BC216 In accordance with paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards*, the Board decided that the modifications to AASB 13 made by this Standard should be applied prospectively for annual periods beginning on or after 1 January 2024.

BC217 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 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)." For the same reason, the Board decided that the modifications to AASB 13 should be applied prospectively.

BC218 The Board considered that the modifications to AASB 13 mainly clarify that Standard, rather than changing its requirements. In applying the modifications, an entity's changing practice in how it measures the fair value of non-financial assets not held primarily for their ability to generate net cash inflows does not indicate an error had been made previously in applying the existing requirements of AASB 13.

BC219 In accordance with paragraphs 37–40 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, prospective application of the authoritative implementation guidance would require an entity to:

(a) recognise any change in asset values by adjusting the carrying amount of the affected assets and equity items in the period of the change; and

(b) disclose the nature and amount of the change in asset values that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

Voluntary restatement of comparative information

BC220 In ED 320, the Board invited comments on whether an option should be provided for not-for-profit public sector entities to elect to restate comparative information to the extent practicable, instead of applying the amendments to AASB 13 prospectively. A majority of those responding to that question disagreed with the provision of such an option, because:

(a) restating comparative information about fair values for prior periods would be likely to involve the use of hindsight;

(b) a change in fair value should be treated as a change in an accounting estimate (ie prospectively); and

(c) it might be confusing for users to understand the fair values presented in financial statements if prior period balances were restated, which would have a flow-on effect to the depreciation amounts previously recognised.

BC221 Having regard to the comments received, the Board decided not to provide an option to restate comparative information upon initial application of the Amending Standard.

Not-for-profit private sector entity consideration

BC222 When developing ED 320, the Board observed that limiting the AASB 13 modifications to not-for-profit entities in the public sector might be perceived as being inconsistent with its transaction neutrality policy. Therefore, ED 320 included a question asking respondents whether the proposed modifications to AASB 13 should be applicable also to entities in the not-for-profit private sector. Mixed feedback was received on that ED question.

BC223 The Board decided to limit the scope of this Amending Standard to not-for-profit public sector entities because the Board did not receive any requests for guidance from stakeholders in the not-for-profit private sector during the project. To the date of issuing this Standard, the Board has not been informed that:

(a) a significant number of not-for-profit private sector entities measure their non-financial assets at fair value;

(b) not-for-profit private sector entities are encountering significant issues with applying AASB 13 in measuring non-financial assets; or

(c) some principles of AASB 13 have been applied inconsistently in this sector in measuring non-financial assets (unlike in the public sector).

BC224 The Board noted that limiting the scope of modifications to not-for-profit public sector entities may not necessarily breach its transaction neutrality policy because many assets held by not-for-profit public sector entities are largely unique to the public sector. That is, for many assets, it is unlikely that private sector entities would hold similar assets to those held in the public sector.

BC225 Even if it were considered that limiting the modifications to not-for-profit public sector entities would be inconsistent with the transaction neutrality policy, the Board considered that this would be justified. This is because, unlike public sector entities, private sector entities have a choice to subsequently measure their non-financial assets using the cost model rather than the revaluation model (in AASB 116 or AASB 138 *Intangible Assets*). This results in non-financial asset values measured using different models among private sector entities' financial statements, thus being less comparable than the asset values reported by public sector entities. Accordingly, applying this Amending Standard, which is limited to measuring non-financial assets using the revaluation model, would not fully achieve comparability among not-for-profit private sector entities in measuring their non-financial assets.

BC226 In accordance with the *AASB Not-for-Profit Entity Standard-Setting Framework*, for the reasons noted in paragraphs BC223–BC225, the Board determined that a case has not been made for it to undertake standard-setting work to investigate whether there is a need to modify AASB 13 for application by not-for-profit private sector entities.

Comparison with IFRS 13

BC227 Not-for-profit public sector entities complying with this Standard might not comply with IFRS 13 issued by the International Accounting Standards Board (IASB).

BC228 This Standard makes the following modifications in comparison with IFRS 13 (which are intended to elaborate its requirements in the public sector context) in respect of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows:

(a) the asset's current use is assumed to be its highest and best use unless at the measurement date it is highly probable that the asset will be sold, distributed or used for an alternative purpose to its current use (paragraphs Aus29.1 and Aus29.2);

(b) if both the market selling price of a comparable asset and some market participant data required to measure the fair value of the asset are not observable, the entity is required to use its own assumptions as a starting point in measuring the fair value of the subject asset and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data (paragraphs F5 and F11(b)); and

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

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

(ii) not identify economic obsolescence for the asset if the asset contains 'surplus capacity' necessary for stand-by or safety purposes (paragraph F17).

BC229 IFRS 13 does not specify:

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

(b) any specific criteria for when market or other factors suggest that an alternative use of an asset by market participants would be the asset's highest and best use. Consequently, the modification of AASB 13 in paragraphs Aus29.1 and Aus29.2 specifying that an asset's current use is assumed to be its highest and best use unless at the measurement date it is highly probable that the asset will be sold, distributed or used for an alternative purpose to its current use creates the potential for particular fair value measurements to be non-compliant with IFRS 13. This is because applying paragraphs Aus29.1 and Aus29.2 might delay the identification of a higher and better alternative use compared with application of paragraph 29 of IFRS 13 alone. The Board concluded such potential for non-compliance with IFRS 13 is warranted by the unique aspects of the processes in the public sector for selling, distributing or redeploying assets (see paragraphs BC35–BC43); and

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

The requirements of this Standard noted in paragraphs BC228 might not comply with IFRS 13.