AASB Staff Issues Paper
AASB 13 Disclosures for Not-for-Profit Public Sector Entities – Evaluating the Case for Modification from IFRS 13

Purpose

1 The purpose of this paper is to:

(a) analyse the case for modification of AASB 13 *Fair Value Measurement* under the *Process for Modifying IFRSs for PBE/NFP* (the *Process*)[1] for property, plant and equipment (PPE) held for its current service potential;

(b) analyse the potential costs and benefits of the additional specified disclosures for such PPE categorised as Level 3 in the fair value hierarchy; and

(c) make a recommendation to the Board whether to propose amendments to IFRS 13, and if so, the extent of the amendments.

Background

2 The December 2014 AASB minutes[2] note the following:

> *The Board discussed the results of the staff outreach activity and alternatives for progressing the project. The Board noted the prevalence in the not-for-profit (NFP) public sector of property, plant and equipment (PPE), including infrastructure assets, measured at fair value, and considered whether the resulting quantum of disclosures added to, or detracted from, the relevance of general purpose financial statements to users. The Board heard the concerns of various Board members as to the extent of aggregation of information that occurs, and the resultant usefulness or otherwise of certain AASB 13 disclosures to the users of NFP public sector general purpose financial statements.*
>
> *The Board also noted that the use of Tier 2 in the public sector would resolve some of these issues and that the principles underpinning Reduced Disclosure Requirements will be reconsidered in the near future.*
>
> *The Board noted that certain disclosures specified by AASB 13 in respect of Level 3 inputs may potentially be of less importance to users where the related assets are not held for the purposes of generating future cash inflows. The Board directed staff to conduct further research into whether a case for modification under the Process for Modifying IFRSs for PBE/NFP could be made for PPE held for its current service potential rather than to generate future cash inflows. The Board also directed staff to conduct a cost-benefit analysis of the additional specified disclosures for such PPE classified as Level 3 in the fair value hierarchy, including exploring the benefits to users of pursuing a potential exemption from these disclosures.*

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1 The *Process* is available on the AASB website: http://www.aasb.gov.au/admin/file/content102/c3/Final_Process_for_modifying_IFRSs_Oct_2009.pdf

2 December 2014 AASB minutes: http://www.aasb.gov.au/admin/file/content102/c3/AASB_Minutes_M142_17-18_December_2014_unsigned.pdf

The Board decided it would be useful for a staff article to be prepared addressing some of the transitional issues for NFP public sector entities identified in the staff outreach. The staff article will also highlight the application of materiality in preparing fair value disclosures.

The Board directed staff to bring back the results of the staff research to a future meeting.

Previous Board decisions – March 2011

3 Staff note that the Board previously considered, with reference to a pre-ballot draft of IFRS 13 *Fair Value Measurement*, potential issues affecting NFP entities on application of AASB 13 at its March 2011 meeting.[3] These issues included concerns that the disclosure requirements of AASB 13 would be onerous to NFP entities and may qualify for modification under the Process. The Board minutes from that meeting note:

"The AASB particularly considered comments from some constituents that the following disclosures, for fair value measurements categorised within Level 3 of the fair value hierarchy, would give rise to costs exceeding the related benefits, and therefore should not be required of NFPs: (a) a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs might result in a significantly different fair value; and (b) a description of any interrelationships between the inputs mentioned in (a) and other unobservable inputs used in the fair value measurement. The Board decided that, if the IASB proceeds with its proposals: (a) there is not a NFP-specific reason to provide an exemption from the abovementioned disclosures; and (b) none of the other issues in the issues paper warrant a NFP-specific modification to the forthcoming IFRS 13 when it is incorporated in an Australian Accounting Standard."

The Board confirmed its decision to not modify IFRS 13 for application by NFP entities at its meeting in June 2011. Accordingly, AASB 13 was issued in 2011 without any amendment for application by NFP public sector entities.

Further background information to the current project

4 Agenda Papers 9.1 and 9.2 from the AASB Meeting 17-18 December 2014 provide further background information to the current AASB project:

(a) Agenda Paper 9.1 *Memo re AASB 13 Disclosures for Not-for-Profit Public Sector Entities* – provides an overview of the project http://www.aasb.gov.au/admin/file/content102/c3/M142_9.1_Memo_re_AASB_13_Disclosures_for_Not-for-Profit_Public_Sector_Entities.pdf

(b) Agenda Paper 9.2 *Staff Paper: Staff Outreach and Alternatives for Progressing the Project* – summarises the results of the staff outreach http://www.aasb.gov.au/admin/file/content102/c3/M142_9.2_Staff_Paper_Staff_Outreach_and_Alternatives_for_Progressing_the_Project.pdf

3 Refer Agenda Paper 9.2 from the AASB March 2011 meeting, available at: http://www.aasb.gov.au/admin/file/content102/c3/Minutes_unsigned_16-17_March_2011.pdf

Research and outreach on the current project

5 Targeted staff outreach on this project was conducted in Q4 2014. As communicated to the Board in Agenda Paper 9.2 of the December 2014 meeting, staff received feedback from a Big 4 audit firm, ANAO (gathered by ANAO staff from a range of sources), the Department of Treasury and Finance (DTF) Victoria (feedback from departments and relevant agencies of the State of Victoria collated by DTF Victoria staff), Western Australia Local Government Finance Professionals, Local Government Finance Professionals NSW, and held face-to-face meetings and teleconferences with other preparers, auditors from State audit offices (2) and valuation experts (2). Staff were also invited to meetings of the Technical Heads of ACAG member offices and the National Local Government Financial Management Forum, where AASB 13 application was discussed. In addition, the issue was also raised at various CPA Congresses. Since Q4 2014, staff have received further feedback on the project from meetings with the South Australian Local Government Financial Management Group, and staff of the South Australian Auditors-General's Department, a Big 4 audit firm, and the Department of Finance. The project was also raised at a fair value seminar hosted by a valuation firm. In addition, as part of the outreach activity, staff performed a limited desktop review of the disclosures presented in published government general purpose financial statements.

Case for Modifying AASB 13

6 The *Process* states that the purpose of modifying IFRSs for public benefit entities (PBE)/NFP entities is to reflect differences between the PBE/NFP and for-profit sectors, including differences in user information needs, that warrant a different accounting treatment or guidance for public benefit and NFP entities. Paragraph 9 of the *Process* notes that the following two questions would generally be considered before modifying an IFRS:

(a) Are there issues that might warrant modifying an IFRS for PBE/NFP?

(b) Are the identified issues sufficiently significant to warrant a departure from an IFRS?

7 The *Process* is premised on the Board accepting that an IFRS represents best practice. Accordingly, the *Process*, as currently drafted, does not consider disagreement with a requirement in an IFRS and/or the IASB's reasons for issuing the IFRS to be, in and of itself, an appropriate basis for modification of an IFRS to require or permit an alternative accounting treatment for NFP entities. Instead, the *Process* requires the identification of NFP specific circumstances as the basis for modification. The AASB has also previously accepted NFP public sector specific circumstances (evaluated together with the costs versus benefits to NFPs) to be an appropriate basis for modification of an IFRS (refer AASB decisions on the accounting for borrowing costs of qualifying assets).

Nature of PPE Held by NFP Public Sector Entities

8 When considering whether there are issues that might warrant modifying an IFRS for NFP, the *Process* requires consideration of the nature of transactions, events and circumstances and their impact on NFP. Staff considered property, plant and

equipment including infrastructure assets (collectively, PPE) held by NFP public sector entities and make the following observations from staff's desktop review of various government general purpose financial statements for the financial year ended 30 June 2014[4]:

(a) PPE is typically measured on the fair value basis[5] and in many instances will represent a significant portion of total assets reflected in the statement of financial position. Significant components of PPE are infrastructure, land and buildings. Other PPE not commonly held by the private sector include cultural assets and earthworks. Local and State Governments have relatively greater holdings of PPE than the Australian Government;

(b) Infrastructure primarily comprises long-life assets such as roads, road infrastructure, stormwater drainage, water supply infrastructure and sewerage, that are not held to generate future cash inflows but are necessary to meet the NFP public sector entity's public service objectives (that is, these assets are held for their current service potential). Similarly, land and buildings are typically held to fulfil the public service objectives of a government entity;

(c) Infrastructure is typically measured at fair value using a cost approach such as depreciated replacement cost and has been predominantly categorised as Level 3 in the fair value hierarchy. Land and buildings are typically measured either using a market approach (where necessary, adjusted to reflect restrictions on the use of the asset) or at depreciated replacement cost, and categorised as Level 3 or (in some instances) Level 2 in the fair value hierarchy. Similarly, heritage and cultural assets are described as being valued using a market approach or depreciated replacement cost;[6]

(d) The significant unobservable inputs described for PPE include useful life, asset condition, replacement costs, land area, zoning, comparable sales, geographical location, rate per square meter, and adjustment for community service obligation; and

(e) Entities described at least 10 different classes of PPE, but generally more.

9 The prevailing practice in the Australian not-for-profit public sector is to revalue property, plant and equipment subsequent to initial measurement and recognition. Staff understand the fair value basis to have been adopted for various reasons including for convergence with Government Finance Statistics (GFS), as a result of a government directive, for better discharge of accountability and stewardship, and/or as it reflects better asset management/asset sustainability practice (especially with

4 Staff concentrated their analysis on Tier 1 NFP public sector entities. Staff did not consider financial statements of government departments/agencies or cemetery trusts, as staff expect these entities would generally be able to avail themselves of the reduced disclosures available to Tier 2 entities.

5 Other than Defence Weapons Platforms (see Agenda Item 2).

6 From feedback received, staff understand that the classification into the hierarchy of similar assets may presently vary from entity to entity (even where the inputs into the model are the same) depending on the views of the entity or its valuer or auditor. For example, staff received feedback that some entities considered inputs obtained from the Rawlinson's Building Price Index to be Level 2 inputs, while others regarded these to be Level 3 inputs.

regards to long-lived assets).[7] Typically, the value in these assets is realised via their use rather than sale.

10 Having regard to the above considerations, staff note that:

(a) IFRS 13 (and similarly, AASB 13) envisages situations in which non-financial assets may be held defensively rather than for the asset's highest and best use (AASB 13.30). Staff think that a comparison can be made between such instances and the assets held by NFP public sector entities to achieve public service objectives, as in both instances the entity's primary objective in holding the asset is not for the purpose of the asset itself generating future cash flows;

(b) While the types of assets held by NFP public sector entities are generally different to the types of assets held by for-profit private sector entities, staff think that it is arguable that this in itself is not a sufficient sector specific differentiator, as within the private sector the assets held by different industries may themselves vary greatly (e.g. mining vs. aviation). Further, staff note that that various water and port government business enterprises (GBEs) also fair value their infrastructure assets (e.g. City West Water, North Queensland Bulk Ports Corporation);[8] and

(c) Staff think that many PPE assets held by private sector entities, if measured on the fair value basis, would likely require a similar valuation methodology to that applied to many assets of the NFP public sector. However, a difference may be the extent of restrictions on the use of the asset, which may be more pervasive for assets held by NFP public sector entities.

Costs and Benefits of the Additional Level 3 Disclosures

11 At its December 2014 meeting, the Board asked staff to consider the costs and benefits of the additional disclosures required of PPE measured at fair value and classified as Level 3 in the fair value hierarchy. These additional disclosures are described in Appendix 1 to this agenda paper.

12 Staff note the following *potential benefits* associated with providing the disclosures above in general purpose financial statements:

(a) Consistency with AASB's transaction neutrality policy;

(b) Provides users with transparency about the fair value measurement of assets categorised as Level 3 in the fair value hierarchy to:

(i) help users understand the measurement uncertainty inherent in the fair value measurement (IFRS 13.BC190-BC191);

7 Staff have sought feedback from some jurisdictions as to whether entities would consider reverting to the cost basis, if the opportunity was available. The feedback received suggested that this would be unlikely as fair value provided more relevant information.

8 Source: 2014 Annual reports of City West Water, North Queensland Bulk Ports Corporation, available at https://www.citywestwater.com.au/documents/annual_report_2014.pdf and http://www.nqbp.com.au/wp-content/uploads/2014/09/NQBP-Annual-Report-2013-2014.pdf

(ii) enable users to assess whether the entity's views about individual inputs differs from their own (IFRS 13.BC192, BC207);

(iii) over time, provide users with information about changes in management's views about particular unobservable inputs and about changes in the market (IFRS 13.BC192);

(c) Allows for comparisons to be made between entities/ jurisdictions for similar assets categorised within Level 3 of the fair value hierarchy (IFRS 13.BC192);

(d) Enhances user assessment of the quality of an entity's reported earnings by requiring segregation of the effects of fair value measurement that are inherently subjective (IFRS 13.BC197);

(e) Enables user assessment of the relative subjectivity of the fair value measurement (IFRS 13.BC200);

(f) Provides users with information about how the selection of unobservable inputs affects the valuation of a particular class of asset, through disclosure of the directional effect of a change in a significant unobservable input (IFRS 13.BC206);

(g) Provides (some) information about the model applied (IFRS 13.BC207); and

(h) Allows for assessment of the 'robustness' of the statement of financial position.

13 However, staff also note the following:

(a) Respondents from local governments expressed the view that ratepayers and other readers of local government financial reports were unlikely to be interested in notes to the financial statements, and that questions were seldom received from the public about the financial statements. Staff also received feedback from some local government respondents that AASB 13 disclosures would not themselves affect local government funding decisions. Other respondents considered the disclosures to be useful as the information allows comparisons to be made across entities with similar assets as to the appropriateness and consistency of the observable input ranges or valuation technique (refer feedback received from staff targeted outreach activities described in Agenda Paper 9.2 from the December 2014 AASB meeting);

(b) Some respondents questioned whether there is any more discharge of accountability, whether information about valuation risks is important to users of local governments whose assets have a community value and whose ratepayers do not make investment decisions based on the council's performance, and whether the disclosures provide any further insight into the condition of council assets. Others considered the disclosures to provide value as they provide the auditor with further insight into/ necessity of focusing on the valuation, and provides users with greater transparency of the fair value measurement of PPE and the robustness of the balance sheet (refer feedback received from staff targeted outreach activities described in Agenda Paper 9.2 from the December 2014 AASB meeting); and

(c) Staff received feedback that in the Commonwealth, government bond analysts are not particularly interested in details about the valuations of non-financial assets as these assets are viewed as sunk costs;

(d) Staff received feedback that in the Commonwealth, concepts such as return on assets are not relevant, and that parliamentary forums (such as committee meeting transcripts, committee reports, auditor-general reports) did not appear to reference fair value information; and

(e) Staff received feedback from a non-preparer that quantitative information about significant unobservable inputs did not provide useful information when fair value was determined using a cost approach (but that this disclosure provides relevant information when a market or income approach was applied).

14 Staff have identified the following as *possible costs* associated with providing the disclosures above with respect to PPE held for current service potential rather than to generate future cash flows:

(a) Perception that taxpayer funds are not being utilised in a value-to-ratepayers manner where expended on financial costs and staff resources necessary to obtain and present these disclosures;

(b) Potential likelihood that fewer users will read the financial statements because of the additional page count and 'clutter';

(c) Information overload to users who do not rely on the information for economic decision-making;

(d) Potential misinformation to users about the quality of the statement of financial position; for example, 'roads' are unlikely to be further disaggregated by location, however the location of the asset may significantly affect the range of quantitative inputs disclosed by asset class;

(e) Unlikely to be particularly relevant for accountability purposes as valuations are influenced by external factors outside the entity's control; and

(f) Ongoing relative costs (time, effort, dollar) of providing meaningful disclosures is likely to be greater for NFP public sector entities than for private sector entities that generally limit fair value measurement of non-financial assets to land and buildings. (Staff observe that even in the event relief from these disclosures is made available for NFP public sector entities, their ongoing costs will continue to be greater given the number of non-financial assets measured at fair value compared to the private sector.)

15 Staff have also identified the following as possible costs of **not** requiring the disclosures noted above:

(a) Lack of information about how the most significant items on an entity's statement of financial position are determined; and

(b) Inability to state full compliance with IFRS; however, staff note that many NFP public sector entities may already presently not state compliance with IFRS.

Staff view

16 Staff do not think that the nature of the public sector assets by themselves is sufficiently different to certain assets held by private sector entities to warrant modifying IFRS 13. However, staff think that the prevalence of fair value measurement for PPE held for its current service potential, and the number and range of PPE in the NFP public sector, results in a cost that exceeds the benefits received.

17 On consideration of the observations in paragraphs 6 – 15 and acknowledging that:

(a) AASB 13 has been on issue since 2011;

(b) constituents now have a fuller appreciation of the Standard's requirements; and

(c) the practical implications of the Standard are now more apparent;

on balance, staff think that it may be argued that modifying IFRS 13 for NFP public sector entities is required as the costs of providing the information exceeds the benefits. Paragraph 20 of the *Process* notes that a particular IFRS requirement may have a disproportionate costly impact on NFP entities because of the frequency of particular types of transactions and other events among NFP entities.

18 Although staff think the ongoing costs of presenting the additional Level 3 disclosures are unlikely to be onerous, staff are concerned that the information presented in its aggregate form is of limited benefit and could potentially misinform users of general purpose financial statements of NFP public sector entities (for example, when different assets in a class have significantly different quantitative inputs). Staff also do not consider that these disclosures provide significantly additional useful information about the service delivery, sustainability, or efficiency and productivity of the NFP public sector entity's PPE.

19 However, staff also acknowledge that there are a number of AASB projects that have the potential to impact on the reporting and disclosure requirements of NFP public sector entities, including:

(a) Review of the Australian Reporting Framework;

(b) Revisions to the principles underlying the Reduced Disclosure Regime (Tier 2); and

(c) AASB staff review of the *Process.*

Staff recommendation

20 Staff considered the disclosures described in the Appendix to this agenda paper having regard to the time and effort that may be required to present these disclosures versus the usefulness of the information provided, and acknowledging that the disclosures pertain to assets that comprise the majority of the entity's asset position. Staff:

(a) **do not recommend** that the Board modify AASB 13.93(g) and AASB 13.93(e)(iv) to relieve entities from providing a description of its valuation processes, and of reasons for transfers into/out of Level 3 of the fair value hierarchy. Staff consider that these disclosure do not require significant additional ongoing effort or cost, but similar to the requirement to disclose a description of the valuation technique and the inputs used in the fair value measurement (AASB 13.93(d)), provides useful information to the user about the relative subjectivity of the fair value measurement and of the entity's key judgements in determining its categorisation of PPE into the fair value hierarchy;

(b) to respond to concerns in relation to costs versus benefits of providing AASB 13 disclosure, **recommend** that the Board provide interim relief to NFP public sector entities from all other additional Level 3 disclosures for PPE held for its current service potential rather than to generate future cash flows (see Appendix 1), pending the outcome of the Board's other projects on Reduced Disclosures Regime (Tier 2), the Australian Reporting Framework and a review of the *Process*. Staff note that other disclosures specified by AASB 13 and related disclosures by AASB 101 *Presentation of Financial Statements* and AASB 116 *Property, Plant and Equipment* will continue to be required, including information about the valuation technique/methods, significant assumptions/inputs applied in estimating the fair value, and a reconciliation of PPE by asset classes determined in accordance with AASB 116.

Question to Board Members

Q1 Do Board members agree with the staff recommendation in paragraph 20 that NFP public sector entities be relieved, only for a limited period, from the additional Level 3 disclosures specified by AASB 13 described in Appendix 1 to the agenda paper, other than with respect to the requirement to disclose a description of the entity's valuation processes (AASB 13.93(g)), and of reasons for transfers into/out of Level 3 of the fair value hierarchy (AASB 13.93(e)(iv))?

Appendix 1: Additional AASB 13 Disclosures Applying To Assets Categorised As Level 3 in the Fair Value Hierarchy

The following is a listing of the additional disclosures specified by AASB 13 applying to assets categorised as Level 3 in the fair value hierarchy. The disclosures are required for each class of asset.

Staff have shaded the disclosures for which staff think relief should **not** be made available.

(a) quantitative information about the significant unobservable inputs used in the fair value measurement (AASB 13.93(d));

(b) for recurring fair value measurements, a reconciliation from the opening balances to closing balances, disclosing separately changes during the period attributable to:

  (i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised;

  (ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised;

  (iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately); and

  (iv) amounts of any transfers into or out of Level 3 of the fair value hierarchy; the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3 (AASB 13.93(e));

(c) for recurring fair value measurements, the amount of the total gains or losses for the period included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised (AASB 13.93(f)); and

(d) a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and processes and analyses changes in fair value measurements from period to period) (AASB 13.93(g));

(e) for recurring fair value measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement (AASB 13.93(h)(i)).