



Staff Paper

March 2011, Joint Agenda Paper J4.3

IVSC ED Technical Information Paper 2 *Depreciated Replacement Cost*

Purpose of this Paper

1. The purpose of this paper is to help the Boards' decide whether to make a submission to the IVSC and, if so, the broad content of such a submission.

Background

2. The Professional Board of the International Valuation Standards Council (IVSC) has released IVSC ED Technical Information Paper 2 *Depreciated Replacement Cost* (ED TIP 2), which proposes updates to its guidance on the depreciated replacement cost (DRC) method of valuation. The comment deadline for the ED TIP 2 is 31 May 2011.
3. The DRC method of valuation is often used for specialised assets, which are rarely sold separately and therefore have little or no comparable sales information available. ED TIP 2 addresses a number of common misunderstandings about the method, and illustrates how it can be applied to provide a realistic valuation in the absence of transactional evidence.
4. The updated guidance aims to clarify the principles that need to be considered with respect to the method, following a number of examples of divergent practice around the world being brought to the IVSC Professional Board's attention. Any eventual guidance is intended to supersede IVSC Guidance Note GN 8 *The Cost Approach for Financial Reporting - (DRC)* (Revised 2005).

DRC in AASB and FRSB Standards

5. Currently in Australia there is no additional guidance for the measurement of DRC, whereas in New Zealand additional guidance on the measurement of DRC is in paragraphs NZ 33.1 to NZ 33.14 of NZ IAS 16 *Property, Plant and Equipment*. Staff are aware that it

is the FRSB's intentions to remove this guidance in the foreseeable future. Despite this, staff are of the view that it is in the best interests of the AASB and FRSB that any IVSC guidance on the measurement of DRC as fair value is consistent with IFRSs (i.e. the forthcoming IFRS 13 *Fair Value Measurement*). Therefore, staff recommend to the Boards that a submission on ED TIP 2 be made to the IVSC.

Key features of ED TIP 2

6. Key features of ED TIP 2 (see agenda paper J4.4) are:
- (a) it distinguishes between the situations in which replacement cost and reproduction cost would be appropriate;
 - (b) it provides guidance on the treatment of interest;
 - (c) it uses the term 'economic obsolescence' rather than 'external obsolescence'; and
 - (d) it notes that when a market basis of value is required for financial reporting, it may also be necessary to consider whether the highest and best use of the subject asset is for the existing use or an alternative use. It states that if the asset potentially has a higher value for an alternative use the DRC method may not provide an appropriate measure of market value (refer paragraphs 56 to 58 of ED TIP 2).
7. We do not think any of these issues¹ would warrant an overall negatively expressed submission to the IVSC². Accordingly, we think a submission that is generally supportive of ED TIP 2 would be appropriate.

¹ Point (b), regarding the treatment of interest, is the subject of agenda paper J4.2.

² We note in relation to point (d) that the discussions of the relationship between market value and DRC in ED TIP 2 and between fair value and DRC in IFRS 13 appear to be different, which may warrant a comment along the lines of the Boards encouraging the IVSC to ensure that its guidance aligns with IFRS 13.

Question for the Boards

Q1 Do the Boards agree that a submission should be made to the IVSC on ED TIP 2?

If yes:

Q2 Should it be a joint submission?

Q3 Should concerns be expressed about any of the proposed guidance (see for example footnote 2 of this paper)?

Q3 Should the submission be finalised out-of-session through a sub-committee?