The Board
Australian Accounting Standards
PO Box 204
Collins St West
VIC 8007

Dear Sirs/Mesdames,

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

In response to the public invitation, Liquid Pacific welcomes the opportunity to submit its views on the proposed amendments to AASB 13 – Fair Value Measurement.

Per our previous submission on this topic, we wish to reiterate, this response is framed by Liquid Pacific's experience in the valuation of non-financial assets for inclusion in financial statements. Liquid Pacific's members are professional independent valuers accredited by the Royal Institution of Chartered Surveyors as Chartered Valuation Surveyors and the Australian Property Institute as Certified Practicing Valuers.

We wish to stress; accredited valuation professionals are providers of independent advice. The independence of the valuation profession is recognised in legislation and valuations are considered by the courts as legal documents. When providing fair values (market value) for use in financial statements, the accredited valuer is assisting their client to fulfil their regulatory requirements. They are not acting as consultants or advocates for their clients and have no pecuniary interest in the valuation outcome.

Liquid Pacific has a number of concerns as to the proposed changes to AASB 13. At a very high level it would appear amendments to accounting standards aimed at accommodating a particular sector of the market is contradictory to the purpose of having accounting standards. It is our understanding the purpose of accounting standards is to create a framework for consistent financial reporting across all entities. By making changes to AASB 13 for the benefit of the public sector appears to contradict the objectives of standard setting.

We believe, if the recommendations are adopted, fair values for certain assets may differ, not only between the private and public sector but also within the public sector itself. The issue then arises as to how users of financial statements can interpret statements if reporting entities are at liberty to adopt definitions to suit their reporting needs? And further, how can a user of financial statements form judgements and make decisions based upon fair value if the interpretation of fair value changes dependent on the entity that holds the asset, and whether that entity's management decides to retain or dispose of an asset. The users we refer to are those other than the reporting entity or the service providers that assist the entity with the compilation of those financial statements.

Our second concern is in relation to the clarity of the proposed changes. What we are able to ascertain in discussions with stakeholders is that the Board seeks to ratify the current practice of valuing public sector assets. Yet, we can find no detailed descriptions of current practice and whether or not the Board considers the current practice is best practice.

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Specifically, we would desire to see further clarity on Aus 28.1.

Aus 28.1 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 capability of the asset to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services.

For us, the amendment is unclear both in its explicit meaning and intended application. Again, in discussion with stakeholders we were able to conclude, (correctly we hope), Aus 28.1 is trying to convey that because assets of this nature are not held to generate net cash inflows, then net income should not be a pricing consideration in determining fair value.

If this is indeed the intention of this paragraph, then we must conclude the income approach to valuation is not a suitable valuation methodology for these types of assets because market participants do not consider net income as a value determinant.

With regard to Aus 28.1, we request from the Board;

1. Can it provide a plain English version of this paragraph?
2. Indicate whether non-financial assets of a not-for-profit public sector entity not held primarily for their ability to generate net cash inflows can be valued using the income approach?
3. If fair value is a measure of an asset's future economic benefits, what benefits are to be measured under Aus 28.1?
4. If net income is the benchmark, then what costs (valuation inputs) are to be ignored in the valuation process
5. Provide working examples of Aus 28.1 including where the asset does not have potential to derive income and where it does.

Another concern is Aus 28.1 creates imaginary markets for public sector assets and for which public sector entities are the only relevant participants. It also implies the holding entity is a market participant and there are sufficient numbers of the same entity to constitute a market. All these assumptions conflict with the real-world acceptance of land economics and with the concept of fair value. Willing buyer, willing seller, arm's length transactions, full knowledge of markets and so on.

The obvious question then becomes what happens to these imaginary markets and market participants when the entity decides to sell the asset? If these assumptions disappear then the Aus 28.1 is most likely to lead to an entity's fair value 'in use' being significantly different to its fair value 'on disposal'.

With reference to the Fatal Flaw Review (FFR), the Board has provided situational examples to assist in demonstrating the concepts of the proposed changes to AASB 13. We believe the concepts within Aus 28.1 have not been demonstrated in these examples.

As to the examples in the FFR documentation, we understand they are intended to be simplified to express clearly the impact of the proposed changes. However, it is our experience accounting standards are taken literally and any omissions are seen to be deliberate, leading to a range of interpretations, which only adds to confusion.

For this reason, we have made the following comments in relation to the examples in the FFR document. To assist with continuity, we have also reproduced the examples.

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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*

Costs to remove unwanted existing structures and disruption costs

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.

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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.

Current replacement cost assessment as at 30 June 20X2

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).

COMMENT

We understand this example is to demonstrate when using the cost approach to valuation, a market participant should take into consideration all costs associated with replacing the asset's service potential. It is our opinion the example fails in this regard.

Firstly, we contend the logic in the example. The statement;

"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."

Could also be restated as;

"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 night time, Council A uses the less costly day-time disruption costs of $1,000,000 in its estimated current replacement cost of the road as at 30 June 20X2 rather than the higher night-time costs."

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This example does not state why one option is preferenced over the other. The example also contradicts one of the fundamental principles of fair value, which is an entity will act in their economic self-interest.

An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. [para 22 AASB 13]

We note this approach is also replicated in the Board's example 3

Secondly, the example states 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. As a consequence Council A had to acquire land. The land was improved and so the Council incurred some $2,000,000 to remove unwanted structures on the land to make way for the construction of the road.

That council had to acquire land in a densely populated area and incurred $2m in removing unwanted structures, implies there are other costs to be considered. To demonstrate these other costs and the magnitude of their impact, we have applied real world assumptions to the example.

Assume Council A's road is located in a Melbourne suburb. Given the construction costs we can estimate the road's length to be some four kilometres. The median value of land in Melbourne is $890 per m2 so the value of the acquired land is approximated at $39,160,000 (4,000m long x 11m wide x $890m2). However, as it is a densely populated area, then a significant number of dwellings would have been acquired. Assume 70% of all the land acquired is improved, then we can estimate some 935 residential properties were acquired to construct the road. The median house value in Melbourne is $775,000 which equates to an acquisition cost of $725m for the improved property. The remainder of the land acquired (30%) is vacant land which equates to another $11.8m (at $850/m2).

Total cost of acquisition is therefore $736m (land and improved land). Add to this the additional costs of compulsory acquisition, (heads of compensation, plus consultant and legal fees, being approximately 35% of the acquisition value) brings the total cost of land and improvements acquired to approximately $994m.

Of the $994m only $340m is attributable to the value of the land acquired (as whole housing blocks also needed to be acquired). The balance is the value of the improvements to the land that was acquired. The extra costs of acquisition are not allocated to the land value because the project has not enhanced the land (unlike example 4) and so must be allocated to the construction cost. Under the cost approach to valuation and the requirement for a market participant to consider all costs in acquiring the same asset, the total cost to a market participant to build the road is no longer the suggested $25.2m but rather $365.2m ($25.2m + $340m), reflecting the costs associated with compulsory acquisition (35%) and purchasing now demolished dwellings.

The cost of the four-kilometre road has changed from $5m kilometre to $91.3m per kilometre. Also note the example's demolition costs in would not be $2m but under realistic assumptions closer to $23m

Based on the premise of this example and to be consistent, if market participants would estimate, in today's terms, what the hypothetical cost of acquiring property and demolishing improvements would to construct a roadway, then it would require the same approach to all roads.

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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.*

Current replacement cost assessment as at 30 June 20X2

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).

COMMENT

Valuation does not make allowances for entity specific circumstances which may also include favourable taxation and financing arrangements.

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.

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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.

COMMENT

From a valuation perspective, we find a number of issues in this example as they relate to fair value.

1. The example is entity specific. The policy is specific to Department B and no other. The objectives of AASB 13 include;

   "Fair value is a market-based measurement, not an entity-specific measurement."

   We ask whether the definition of fair value is to be amended for the public sector or is Aus 28.1 intended to override the 'entity specific' requirement by creating imaginary markets and market participants?

2. As Government B is not mandated to purchase local, it does not appear to be acting in its economic best interest.

   "An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest."

   Again, does the definition of fair value need to be changed to accommodate the public sector? Or as stated above Aus 28.1 is intended to override the 'entity specific' requirement of fair value, as well as the requirement for the entity to act in its own 'economic best interest'?

3. The example implies that Department B is both the willing seller market participant and the willing buyer market participant and that it alone constitutes an active and liquid market. These assumptions also contradict the definition of fair value and the principles that underpin it.

4. The example appears to contradict the treatment recommended in F10 of the FFR.

   "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."

5. The example states; *Since there is no reasonably available information indicating that another market participant would acquire railway tracks overseas. . ."*. Similarly, there is no available information to indicate a market participant would NOT acquire railway tracks overseas. Fair value dictates a market participant would seek to act in their own economic interests.

6. The example implies political motivation is also a valuation input. We assume the Board does not envisage all Government assets be revalued after each election, so question the relevance of such considerations.

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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 approach; 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

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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.

COMMENT

We wish to point out we consider the fair value for this example to be entity specific.

"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."

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."

Clearly, the accounting policy is entity specific and does not transfer with the property. As we stated previously, our understanding is that fair value is not entity specific.

With reference to the first point (a) in this example, we wish to stress, land and buildings are usually economically dependent on each other. A significant number of public sector entities, especially local government, value one class to the exclusion of the other and by doing so potentially misrepresent the actual value of either their land portfolio or their building portfolio.

For the first point (d) in the example, that agencies can and do create policies in relation to the valuation of assets does contribute to a divergence in asset values for which this project was initiated and amendments to AASB 13 are meant to resolve. Maybe the Board would have more success in negating divergence if it mandated policies are not valuation inputs.

In this example a market participant would not necessarily be concerned if the subject land had been contaminated and then remediated (as long as it was independently certified as clean) or the cost of that exercise, or whether the cost was allocated to the asset class building or not. In line with accepted market behaviour and typical transactions of real property assets, a market participant would consider the building and the land it sits on as being one asset for purchase.

A market participant would determine the fair value of the property (land and buildings) with regard to sales of similar property.

However, in the absence of market transactions for similar property it is expected the market participant would consider the market value of the land as it exists (which is uncontaminated) and the added value of improvements (assuming a cost approach) and summate both values to arrive at an estimate of fair value (market value) for the property.

If we assume a fair value for the uncontaminated land to be $20m and the depreciated replacement cost of the building is $25m, then the market participant would only pay $45m for the facility. There are no scenarios that would make this allocation of value change.

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The idea that the $5m spent to decontaminate the land is a construction cost allocated to the cost of the facility is inherently incorrect. Assuming common sense applies, the value of the land when contaminated had a maximum value of $15m for which the $5m cost of remediation brought the value of the land to a fair value (market value) for uncontaminated land, being $20m. The cost to remediate added value to the land and the betterment stays with the land at sale. To demonstrate this concept, the remediated land can now be sold for $20m before the quarantine facility is even built.

Often what happens in the public sector is an agency will value their buildings in one financial year and their land in a separate financial year (or have different service providers allocated to each). If Department C adopted either scenarios A or C in the example, then the implications for Department C in Example 4, is that a fair value of $30m will be allocated to the quarantine facility in year 20X1 and in year 20X2, when the land is valued, it will be allocated a fair value of $20m. Department C has then over-valued its asset base by $5m (11%), which then misrepresents their financial position.

When market evidence is available, valuers will value the property as above and then deduct from that value their estimate of the land value to deduce a value of the improvements. When market evidence is not available, they will seek to replicate the market approach to the best of their ability using available information.

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.

COMMENT

Firstly, we consider this example contradicts the school example in F18 of the Exposure Draft 320. In F18 of ED320 the Board states

"An example of where economic obsolescence of an asset would be identified when applying the principles in paragraphs F16 and F17 is a public school building that has 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, the school building's 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 building (eg physical obsolescence) would be deducted."

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F18 appears to state the cost approach to valuation should be the asset's gross replacement cost (GRC) less economic obsolescence (EO), less all other obsolescence (AoO). Whereas, the kitchen example above appears to state, GRC - AoO – EO.

The difference can be significant as it pertains to the impact on an asset's value of any particular obsolescence, as the following demonstrates (assume the kitchen gross replacement cost is $500,000, EO = 25% and AoO = 50%).

Table 1 – Depreciation Charges

College A - Kitchen Replacement				
A - F18 ED320 Approach		Depreciation	Sub-Total	Total
Gross Replacement				$500,000
EO	25%	$125,000	$375,000	
AoO	50%	$187,500	$187,500	
Fair Value				**$187,500**
B - Example 5 - FFR Approach				
Gross Replacement				$500,000
AoO	50%	$250,000	$250,000	
EO	25%	$62,500	$187,500	
Fair Value				**$187,500**

In the above calculations, whilst the simplified fair value calculation and percentage of economic obsolescence remains the same, the monetary impact for each obsolescence on the kitchen's gross value varies significantly. Calculation A tells us the economic impact on College A's kitchen is $125,000, whereas calculation B states it is only $62,500.

We consider calculation A may lead a market participant to consider the purchase of the kitchen (presumably along with college) represents a significantly riskier investment than demonstrated in calculation B. Calculation A is stating the kitchen asset is in reasonable condition and is both functionally and technically healthy but has been significantly under-utilised. The under-utilisation of the asset may then lead the market participant to conclude the College's chef course is running poorly and possibly the college generally. Therefore, in pricing this asset a market participant may discount the fair value even further to allow for the inherent risk of further under-utilisation.

Whereas, calculation B implies the kitchen is well used, but functionally and technically, and from a condition viewpoint is heading into the backend of its useful life. A market participant may consider the economic obsolescence in this calculation to be minimal and the purchase a less riskier option than what is demonstrated in calculation A.

It is expected a market participant would consider the monetary value applied to each type of obsolescence in pricing an asset. Regardless, we consider both calculations to be incorrect as they assume a hierarchy of obsolescence exists.

To demonstrate economic surplus, it would have been helpful to have the example show what constitutes economic surplus and the impact on the value of the kitchen asset. In the literal, it is not our experience kitchens within such higher education environments are separately subject to the economic obsolescence test. Rather, it was our feedback to ED320 which stated our research into higher education facilities demonstrated these institutions do not consider economic obsolescence for any assets, whatsoever.

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We thank you for the opportunity to address the Fatal Flaw Review and this part of the project will bring about clarity to any proposed changes which will benefit both the reporting entities and the users of financial statements

Yours faithfully

……

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