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The Chair
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

via email: standard@aasb.gov.au

Dear Keith,

AASB Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities*

Deloitte is pleased to respond to the Australian Accounting Standards Board ('AASB' or 'Board') Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* (ED 320). We appreciate the opportunity to comment on this Exposure Draft to ensure the proposals as a whole address the specific concerns raised by stakeholders and issues we have observed in practice.

We agree with the majority of the proposals in ED 320, and we note that for the project to be successful in reducing divergence in practice, it will be critical for financial reporting professionals to work closely with valuations professionals in implementing the proposed guidance.

However, we do hold concern over the proposals regarding the consideration of obsolescence in determining fair value. We are of the view that until the appropriate level of the entity's management is committed to reducing an asset's physical capacity there should not be any estimate of obsolescence included in a fair value measurement. In our opinion, to endeavour to build estimates of obsolescence into fair value where a decision has not been made would be time consuming, costly, and does not truly represent the characteristics of public service assets, which by their nature will have fluctuations in demand for their use over time.

Our detailed responses to the specific matters for comment in the exposure draft are outlined in the Appendix.

Please contact me at +61 9671 7871 or moverton@deloitte.com.au if you wish to discuss any of our comments.

Yours sincerely

Moana Overton
Partner

APPENDIX – DETAILED RESPONSE TO THE AASB REQUEST FOR COMMENTS IN ED 320

Proposed guidance for Public Sector Not-for-Profit entities on the application of AASB 13 *Fair Value Measurement*

Scope

1. **Do you consider that the proposed authoritative implementation guidance should be applicable also to Not-for Profit (NFP) entities in the private sector? Please provide reasons to support your view.**

   No, we do not consider that the proposed authoritative implementation guidance should be applicable to NFP entities in the private sector. The guidance has been drafted to address specific issues within the public sector that arise primarily because of the requirements of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* paragraph 13 which require most non-financial assets of public sector entities to be subsequently measured at fair value. NFP entities in the private sector generally have greater discretion in electing to carry assets at fair value, and in our experience those entities are significantly more likely to choose a cost approach.

   Because the guidance is developed with the specific circumstances of entities in the public sector in mind, we think there is a risk that unintended outcomes could arise if NFP entities in the private sector were mandatorily required to apply the guidance set out in ED 320. Instead, we think a better approach would be to not extend the scope, allowing NFP entities in the private sector that do elect to measure their non-financial assets at fair value to access this guidance through application of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to the extent it would be relevant to their specific circumstances. This approach would appropriately permit such entities to consider other appropriate accounting policies rather than being required to apply a methodology explicitly developed for a different sector.

2. **Do you agree with the AASB's conclusion that determining appropriate measurement techniques for measuring the fair value of land and improvements on land subject to public-sector-specific legal restrictions is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards (see paragraphs BC164–BC170)? Please provide reasons to support your view.**

   We agree with the AASB's proposal that determining the appropriate measurement technique for measuring the fair value of land and improvements on land is best regarded as relating to valuation assessments and should not be mandated in Australian Accounting Standards. AASB 13 was drafted to support valuation professionals in performing fair value measurements to be used in financial reporting. We concur with the Board's observations that in developing AASB 13 (and IFRS 13 *Fair Value Measurement* on which AASB 13 is based), mandating a single valuation technique was considered but rejected on the basis that fair value measurement is for a particular asset (AASB 13 paragraph 11) and determining the appropriateness of a particular valuation technique requires judgement in each circumstance, even for similar assets (IFRS 13 paragraph BC142). With reference to the *AASB's Not-for-Profit Entity Standard-Setting Framework,* we are not aware of any argument that would suggest the AASB should amend this principle for NFP entities in the public sector.

   Consistent with the conclusions reached by the AASB in ED 320 paragraph BC170, if there is desire for greater consistency in the valuation approaches used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, Treasury, Finance Departments or other authorities could designate this through financial reporting guidance relevant to those jurisdictions. The role of accounting and financial reporting should not, in our opinion, interfere with the professional expertise of valuation professionals.

Market participant assumptions

3. **In respect of the assumptions used in measuring the fair value of a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, do you agree with the proposals in paragraphs F4-F7 that:**

(a) if the market selling price of an identical asset is directly observable, that price (which incorporates implicitly the assumptions that other market participants would use when pricing the asset, negating the need to identify those assumptions) should be used to estimate the fair value of the asset; and
(b) if the market selling price of an identical asset is not directly observable, the entity would need to explicitly estimate the pricing assumptions that other market participants would use. In this case, to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:

    (i) if all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity should use those assumptions in measuring the fair value of the asset; or
    (ii) if not all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity would need to develop unobservable inputs in measuring the fair value of the asset. When applying paragraph 89 to develop unobservable inputs, the entity should use its own assumptions as a starting point and make adjustments to those assumptions if reasonably available information indicates that other market participants would use different data; or
    (iii) if no relevant information about other market participant assumptions is reasonably available, the entity should use its own assumptions in measuring the fair value of the asset?

Please provide reasons to support your view.

We agree with these proposals. In many instances, due to the nature of the assets in question, there is no obvious market for these assets. In such instances, using the entities own assumptions is a reasonable position to take, particularly given many of these assets are often highly specialised, and consequently the inputs arising from identified external market participant assumptions are unlikely to be relevant or reliable (if available at all).

We are of the view that the proposals provide a useful framework to ensure NFP entities in the public sector are considering market participant assumptions where they are available, but are not burdened with trying to identify assumptions that practically may not exist. In our opinion, the guidance as drafted will provide clarity in the steps to be taken to measure the fair value of a non-financial public sector asset in a cost effective and efficient manner.

4. Paragraph F8 provides examples of assets for which:

    (a) market selling prices of an identical or a comparable asset are unlikely to be directly observable; and
    (b) no relevant information about different assumptions of other market participants is likely to be reasonably available.

    Do you agree with the examples in paragraph F8? Please provide reasons to support your view.

We agree the examples provided in paragraph F8 are the types of assets where market prices are unlikely to be observable and that no relevant information about different assumptions of other market participants is likely to be reasonably available.

Highest and best use

5. Do you agree with the proposal in paragraphs F9–F11 that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use should be rebutted when, and only when, the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or to use the asset for an alternative purpose? Please provide reasons to support your view.

We agree with the proposal in paragraphs F9-F11 regarding the rebuttable presumption that the current use is the highest and best use. We consider this to be appropriate because in the public sector, the decision to change the use of an asset can often be a protracted process, and as such to consider the highest and best use of an asset as different from its current use would be costly and burdensome in the valuation process. In our opinion any attempt to incorporate a different use for the asset prior to management's commitment to change its use or sell the asset would add significant cost to the valuation exercise, and open the possibility that the valuation changes significantly in future periods if the plans or expectations are altered, which is not an uncommon occurrence in the public sector. We further note that because of the specialisation of the assets in question, an asset's current use would often also be its highest and best use (because there may be limited alternate uses for the specialised asset).

6. **Do you agree with the example in paragraph F10 of steps that might, in some circumstances of a particular entity, need to be completed before the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or use the asset for an alternative purpose, namely:**
   (a) **relevant field studies or a Ministerial briefing on whether there is a market for the asset (and, if so, its likely price) or for the alternative services that the asset could be used to provide;**
   (b) **initial due diligence processes to determine that a sale of the asset or an alternative use of the asset is possible within the current socio-economic environment and would maximise the asset's value; and**
   (c) **development of project milestones and expected timelines to complete the sale or the plan to use the asset for the alternative purpose?**

   Please provide reasons to support your view.

   We agree that these are representative of the types of steps that would be taken to determine if an appropriate level of management has committed to a plan to sell the asset or use the asset for an alternative purpose. As highlighted above, the decision to change the use of an asset in the public sector can be a protracted process and we consider that the steps above will be useful in informing an entity's decision as to whether potential alternative uses should be considered in determining the valuation methodology.

7. **Do you agree with the proposal in paragraph F12 that an entity is only required to assess whether a use of the asset is physically possible, legally permissible and financially feasible in accordance with paragraph 28 when (per paragraph F9) the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use is rebutted? Please provide reasons to support your view.**

   We agree with the proposal set out in paragraph F12 that only where it is determined that the current use may not be the highest and best use should it be considered whether alternative uses are physically, legally and financially feasible. This is primarily because in most instances any alternative use would not be legally permissible because of, for example, zoning requirements on the use of land. As an example, more often than not, the highest and best use of a school site is not going to be the provision of public education, but for a car park, or a shopping centre. However, these alternatives are not possible because of the zoning restrictions on the land. Therefore, it does not appear appropriate to consider alternative uses unless the appropriate level of management has committed to a plan to sell the asset or to use the asset for an alternative purpose.

8. **Do you agree with the draft implementation guidance in paragraph F13 for applying the 'financially feasible use' concept described in AASB 13 paragraph 28(c), namely that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, a use is financially feasible if market participants (including NFP public sector entities) would be willing to invest in the asset's service capacity, considering both the asset's ability to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services? Please provide reasons to support your view.**

We agree with the proposal as set out in paragraph F13. We note that the assessment is only relevant where the commitment has been made by an appropriate level of management to change the use of the asset. Where that commitment is made and an alternative highest and best use identified, then willingness to invest in the service capacity of that asset is an appropriate consideration to determine if that alternative highest and best use is financially feasible.

Application of the cost approach

9. **Do you agree with the proposal in paragraph F14(a) that the entity should assume the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location? Please provide reasons to support your view.**

   We agree with the proposal set out in paragraph F14(a) that an entity should assume the asset would be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location. The time and effort that would be required to identify and factor in the cost differential for relocating the asset would not result in more useful financial reporting. Accordingly, we consider it appropriate that an entity assumes that the current location is where the replacement asset would be constructed.

10. **Do you agree with the proposal in paragraph F14(b) that the entity should assume that the asset subject to measurement (the subject asset) presently does not exist; and therefore, all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date should be included in the asset's current replacement cost? Please provide reasons to support your view.**

    We agree with the proposal in paragraph F14(b) that the entity should assume that the asset subject to measurement presently does not exist. In applying such a premise, the method of identifying the replacement cost will closely replicate the costs incurred in constructing the asset. We have observed instances where there is an immediate adjustment to a newly constructed asset because of differences in how the cost of the asset is initially measured applying the principles of AASB 116 *Property, Plant and Equipment* and the determination of the replacement cost under AASB 13. As an example, we have seen instances where costs such as site preparation works and project management fees have been appropriately incorporated in the initial measurement of an item of property, plant and equipment, but were subsequently not considered an appropriate input to the determination of fair value, resulting in practically immediate write downs. Therefore, the clarification that the replacement cost is to be considered the replacement of an asset that doesn't presently exist should help to eliminate some of these counterintuitive fair value adjustments.

11. **Do you agree with the proposal in paragraphs F14(b) and F14(c) that, when estimating the current replacement cost of the subject asset, the entity should estimate the replacement cost of a reference asset (ie a modern equivalent asset or a replica asset) as input and adjust the estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset? Please provide reasons to support your view.**

    We agree in principle with the proposal regarding the use of a reference asset to estimate the replacement cost of the subject asset. We have observed that this is commonly applied in practice, however, there are instances where reference to a modern equivalent can create confusion in the accounting for an asset. As an example, in determining the fair value of a road, the construction techniques and safety standards of how a road will be constructed will have changed. This however, does not ultimately change the service capacity of a road, in that the same number of cars can still drive on the road at any given time. The impact of this is that the replacement cost of the replica asset is higher, but in bringing it back to its depreciated replacement cost it can give the impression that the road is in fact impaired because it is not of the same specifications or standard of the modern replacement asset. We have historically observed some confusion in practice and clarification of the appropriate treatment where a modern replacement asset would have different attributes to the existing asset is valuable.

12. **Do you agree with the proposal in paragraph F15(a) that once-only costs that would be expected to be necessarily incurred in a hypothetical acquisition or construction of the subject asset should be included in that asset's current replacement cost? Please provide reasons to support your view.**

    We agree in principle with this proposal. Similar to our response in question 10, we believe that this represents what it would cost to acquire the asset. As described in the example, it is suggested that the replacement cost should reflect how an entity would acquire an asset as if they were starting the acquisition process from scratch. Accordingly, this would include once-only costs.

13. **Do you agree with the proposal in paragraph F15(b) that, when estimating the current replacement cost of the subject asset, an entity should determine, based on the circumstances of the subject asset, whether the following costs would (among other costs) need to be incurred upon the hypothetical acquisition or construction of that asset at the measurement date:**

    (a) unavoidable costs of removal and disposal of unwanted existing structures on land; and
    (b) any disruption costs that would hypothetically be incurred, when acquiring or constructing the subject asset at the measurement date, including costs of restoring an asset not controlled by the consolidated group (if any) to which the entity belongs?

    Please provide reasons to support your view.

    We agree in principle with this proposal. We do see divergence in practice as to how these issues are addressed in practice. Typically the reference asset is determined and replacement rates are identified and applied to the asset that the entity is operating. We note that in our experience it is uncommon for entities to consider these unavoidable costs (such as site preparation) in determining replacement costs. Therefore, although we agree with the proposals, we do highlight that this may lead to some initial change in practice and may require some entities to develop relevant assumptions for the first time which will naturally require time and resources. For the avoidance of doubt, we agree with the proposal and note that this potential change in practice supports the relatively long time between issuing a final standard and the effective date, as is proposed by ED 320.

    With regard to disruption costs, we do agree that if we are trying to represent what it would cost to replace the asset, disruption costs should be considered in representing the fair value of the replacement of that asset, because those costs form part of the basis of the fair value assumptions – that is one of the factors a market participant would consider is that by purchasing the asset rather than building a new one, they would avoid any costs of disruption, and therefore be willing to factor those avoided costs into their purchase price.

14. **Do you agree with the proposal in paragraph F15(c) that an NFP public sector entity includes in the subject asset's current replacement cost all necessary costs required to be incurred in the context of the entity's expected manner of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity? Please provide reasons to support your view.**

    Please note that Illustrative Examples 1 and 2 illustrate the application of paragraphs F14 and F15.

    We agree with the proposal in paragraph F15(c) and note that the illustrative examples are easy to follow in how you would apply these paragraphs. In practice, advice would be sought from quantity surveyors and valuation professionals working with the professionals that manage and work with the assets to determine the approach to valuing the asset. We do observe that the proposals are reflective of our experience as to what is currently happening in practice to determine the replacement cost of assets.

Economic obsolescence

15. **Do you agree with the proposal in paragraph F16 that identifying economic obsolescence should not be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity? Please provide reasons to support your view.**

    No, we do not agree with the proposal in paragraph F16. In our view, identifying economic obsolescence should be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity. As we have previously noted, decision making in the public sector can be a protracted process, and often options explored for reducing physical capacity are not executed for a range of policy reasons. Our view is that it is more appropriate that the asset's physical capacity be derecognised only at the point that a decision has been made to discontinue that capacity, rather than endeavouring to factor this into fair value measurement prior to a decision being made.

    In the example given in paragraph F18 regarding the demographic changes and impact on student enrolments, we believe such a change does not necessarily indicate that the asset's value is overstated, but is rather an indicator the asset may not be used to its full capacity at that point in time. It is also not necessarily true that the value of the asset is reduced in these circumstances, as many of the facilities of a school (for example) are necessary to operate at any capacity. As noted in the paragraph above, in the circumstances described in proposed paragraph F18, we consider it would be more appropriate to base the assessment of obsolescence on the formal decisions of the public sector entity's governing body, noting a change in demographics would likely be a catalyst for the public sector entity to assess (and decide) whether part of the asset's physical capacity should indeed be reduced.

    Paragraph BC136 discusses the alternate views that obsolescence should not be considered until a formal decision has been made, given that it's highly unlikely to be clear whether and to what extent economic obsolescence exists. We acknowledge the AASB's view that the primary consideration in assessing when to identify economic obsolescence is to consider if a market participant would deduct an amount of obsolescence from the asset's replacement cost. However, this does appear to contradict the proposed guidance in paragraph F5(b) which notes that in the absence of relevant information about market participant assumptions, the entity should use its own assumptions as a starting point and adjust where relevant. We agree with the view that until a decision is made regarding excess capacity, it is unclear to what extent economic obsolescence exists.

16. **Do you agree with the proposal in paragraph F17 and the example in paragraph F18 that economic obsolescence should not be identified for any 'surplus capacity' of an asset that is necessary for stand-by or safety purposes (eg to deal with contingencies), even if it seldom or never is actively utilised? Please provide reasons to support your view.**

    Yes. We agree with this proposal. This type of 'surplus capacity' is common in the public sector. To be adjusting for this type of surplus capacity would create additional burden on reporting entities as well as the cost of managing these valuations. Our support for this proposal aligns with our reasoning as to why service capacity shouldn't be factored into the replacement cost of a specialised public sector asset.

    We also recommend the AASB consider expanding the circumstances in which this guidance would apply beyond only stand-by or safety purposes. Surplus capacity can also exist in the absence of economic obsolescence where, for example, an asset is underutilised, but still necessary to meet the objectives of the entity in question. As an example, a Technical and Further Education (TAFE) building may include a commercial kitchen that is necessary to be able to train students, but may only be used twice per week. Although the commercial kitchen is not utilised to its full capacity in this example, it is still necessary for the TAFE to have (and would be necessary to replace) to fulfil its objectives.

This would also be consistent with our views expressed in the question above that there may be various reasons why an asset may surplus capacity without necessarily suffering from obsolescence.

Application of the proposed implementation guidance

17. **Do you agree with the proposal in paragraph AusC6.1 that the proposed authoritative implementation guidance set out in Appendix F should be applied prospectively? Please provide reasons to support your view.**

    We agree that the proposed authoritative implementation guidance should be applied prospectively. The guidance is to be issued to support the application of AASB 13. The guidance in many instances is confirmation of how entities have been applying AASB 13 and in that case a prospective application is appropriate as it codifies practice as opposed to changing practice.

18. **If you agree with prospective application in Question 17, do you consider that it would be appropriate for the AASB to provide an option for an NFP public sector entity to elect to restate comparative information as if the authoritative implementation guidance in Appendix F had been applied from a preceding period? Please provide reasons to support your view.**

    We are of the view that it would not be appropriate to allow entities the option to re-state comparative information. Prior to any authoritative guidance, not-for-profit public sector entities have been applying AASB 13 and have been working with valuation professionals to determine the fair value of their assets. Re-statements of these balances would create confusion around what fair value means and would also result in unnecessary adjustments to the reporting of Whole of Government financial statements as the impact of depreciation flows through to the comprehensive result.

19. **If you consider it appropriate for the AASB to provide an option for an NFP public sector entity to restate comparative information (see Question 18), do you consider it appropriate that, if an entity elects to restate comparative information, it should be required to disclose the amount of the adjustment for each financial statement line item affected, as if the implementation guidance had:**

    (a) always been applied (ie full retrospective application in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors); or
    (b) been applied from a specific preceding period, for example, the beginning of the immediately preceding period presented in the financial statements (ie modified retrospective application)? If so, please specify which preceding period you think would be appropriate. Please provide reasons to support your view.

    Consistent with our view expressed in response to question 18, we note that consideration of either transitional option above would result in significant cost in the determination of opening balances, and we do not believe that allowing this option would serve a useful purpose in improving the relevance and reliability of public sector financial reporting.

20. **Further to Question 19, do you consider it would be appropriate for such optional restatements, if elected, to be required for all affected assets, except to the extent it is impracticable for the entity to determine either the period-specific effects of the implementation guidance or the cumulative effect of the change? Please provide reasons to support your view.**

    We believe that in principle, if such an accounting policy choice were elected on transition, it would be appropriate for the election to be made in respect of each class of assets, as this is consistent with how accounting policy choices related to property, plant and equipment are able to be made in accordance with AASB 116 more generally.

21. **Do you agree that the proposed authoritative implementation guidance set out in Appendix F should be applied for annual periods beginning on or after 1 January 2024, with earlier application permitted? Please provide reasons to support your view.**

    We agree with the proposed timeline. This will allow entities to work with their valuation teams to ensure that any amendments to the current approach can be identified and changes can be planned in time to be applied for valuation cycles.

General matters for comment

22. **Whether the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft?**

    Based on our observations we believe the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft.

23. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?**

    We are not aware of any regulatory issues that may impact the implementation of the proposals. We do note however that in applying AASB 13 financial reporting professionals are reliant on valuation professionals, and their application of relevant professional standards.

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

    We believe that this would result in financial statements that are more comparable across jurisdictions. There is divergence across the various jurisdictions within Australia in the application of fair value. For the guidance to result in financial statements that are useful to users it will be essential that financial reporting professionals are working closely with valuation professionals to implement the guidance.

25. **Whether the proposals are in the best interests of the Australian economy?**

    We have no comments regarding the proposals and their impact on the Australian economy.