AASB Exposure Draft

ED 320
March 2022

Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

Comments to the AASB by 30 June 2022

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 30 June 2022.

Formal Submissions

Submissions should be lodged online via the "Current Projects – Open for Comment" page of the AASB website (www.aasb.gov.au/current-projects/open-for-comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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Introduction

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Why we are making these proposals

Some stakeholders provided feedback to the AASB that there is divergent practice by not-for-profit public sector entities in applying the principles in AASB 13 *Fair Value Measurement* in measuring the fair value of non-financial assets. In particular, these stakeholders asked the AASB to provide guidance on how to measure the fair value of non-financial assets not held primarily for their ability to generate net cash inflows. The AASB considered the feedback received and decided to address the implementation issues.

What we are proposing

This Exposure Draft proposes authoritative implementation guidance on AASB 13, and illustrative examples, for application by not-for-profit public sector entities.

Specifically, this Exposure Draft proposes implementation guidance in respect of non-financial assets not held primarily for their ability to generate net cash inflows, regarding:

(a) the market participant assumptions to use in measuring the asset's fair value;

(b) the asset's highest and best use; and

(c) the application of the cost approach if used to measure the asset's fair value.

Who will be affected

The proposals in this Exposure Draft are applicable to not-for-profit entities in the public sector that are required to prepare general purpose financial statements.

Transition

It is proposed that the amending Standard would be applied prospectively.

Application date

It is proposed that the amending Standard would be applicable to annual periods beginning on or after 1 January 2024, with earlier application permitted.

What happens next

The AASB will consider feedback on this Exposure Draft at future meetings and, based on the information received, will determine whether the proposals should form the basis of an amending Standard, with or without further amendment.

Depending on the nature and extent of the feedback, the AASB may publish a Fatal-Flaw Review Draft to enable further consultation with stakeholders.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by 30 June 2022. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Specific matters for comment

The AASB would particularly value comments on the following proposals made specifically in respect of not-for-profit (NFP) public sector entities regarding fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows:

Scope

1 Do you consider that the proposed authoritative implementation guidance should be applicable also to NFP entities in the private sector? Please provide reasons to support your view.

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.

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.

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.

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.

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.

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.

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.

Application of the cost approach

Questions 9–16 relate to applying the cost approach under AASB 13 paragraphs B8–B9.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

General matters for comment

The AASB would also particularly value comments on the following general matters:

22 Whether 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?

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

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

26 Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?

27 Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

Contents

[Draft] Australian Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* is set out in paragraphs 1–7. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2022-X

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

Main features of this Standard

Main requirements

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

(a) if the market selling price of an identical asset is not directly observable, the entity still maximises the use of observable inputs in measuring the fair value of the asset; however, if the entity needs to develop unobservable inputs, the entity uses its own assumptions as a starting point and makes adjustments to those assumptions if reasonably available information indicates that other market participants would use different data;

(b) the circumstance in which market or other factors indicate that an alternative use to the entity's current use of the asset has become the asset's highest and best use (referred to in AASB 13 paragraph 29) is 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;

(c) the requirements in AASB 13 paragraph 28 are applied only when the presumption in AASB 13 paragraph 29 that an asset's current use is its highest and best use is rebutted;

(d) when applying AASB 13 paragraph 28(c), an asset's use would be considered 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 asset's ability to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services; and

(e) when applying the cost approach to measure such an asset's fair value:

    (i) it is assumed that the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location;

    (ii) all necessary costs intrinsically linked to acquiring or constructing the asset subject to measurement (the subject asset) at the measurement date are included in the asset's current replacement cost because it is assumed that the subject asset presently does not exist and all components of the asset need to be replaced. The subject asset's current replacement cost is measured by adjusting the estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset;

    (iii) identification of economic obsolescence is not limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity; and

    (iv) 'surplus capacity' of an asset that is necessary for stand-by or safety purposes is not identified as representing economic obsolescence.

Application date

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

[Draft] Accounting Standard AASB 2022-X

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

Keith Kendall
Dated … [date] Chair – AASB

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

Objective

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

Application

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

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

Amendments to AASB 13

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

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

5 Appendix F *Australian implementation guidance for not-for-profit public sector entities* is added as set out on pages 11–13 of this Standard.

6 *Australian illustrative examples for not-for-profit public sector entities* is attached to accompany AASB 13 as set out on pages 14–15 of this Standard.

Commencement of the legislative instrument

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

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

This appendix is an integral part of the Standard. It describes the application of paragraphs 22, 23, 28, 29, 61, 89, B8 and B9 and has the same authority as the other parts of the Standard. The appendix applies only to not-for-profit public sector entities.

Introduction

F1 AASB 13 *Fair Value Measurement* incorporates International Financial Reporting Standard IFRS 13 *Fair Value Measurement*, issued by the International Accounting Standards Board. Consequently, the text of AASB 13 is generally expressed from the perspective of for-profit entities. The AASB prepared this appendix to explain and illustrate the application of the principles of paragraphs 22, 23, 28, 29, 61, 89, B8 and B9 of the Standard by not-for-profit public sector entities in relation to fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows. This appendix does not apply to for-profit entities or not-for-profit private sector entities or affect their application of AASB 13.

F2 This appendix should be read in conjunction with the requirements of this Standard.

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

F3 Paragraph 22 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. Paragraph 23 states that, in developing those assumptions, an entity need not identify specific market participants; and paragraph 89 states that (in relation to unobservable inputs for an asset) an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.

F4 For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows:

(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, as referred to in paragraph 22) shall 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 explicitly estimates the pricing assumptions that other market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

F5 For a non-financial asset of the type referred to in paragraph F4, in applying the principles in paragraphs 61 and paragraph F4(b) to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:

(a) if all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity shall use those assumptions in measuring the fair value of the asset. For example, the entity uses the observable market price of a comparable asset to measure the fair value of the asset subject to measurement, by adjusting for the differences between the comparable asset and the asset subject to measurement using relevant market data; or

(b) 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 shall 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.

F6 For the purpose of paragraph F5(b), if no relevant information about other market participant assumptions is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset.

F7 For the purposes of paragraphs F5 and F6, exhaustive efforts need not be undertaken to identify whether relevant information about other market participant assumptions is reasonably available or whether the entity's own data should be adjusted.

F8 Examples of assets for which market selling prices of an identical or a comparable asset are unlikely to be directly observable and no relevant information about different assumptions of other market participants is likely to be reasonably available include infrastructure (eg roads, drainage and sewerage works), prisons, parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, community facilities (eg toilet blocks) and most defence weapon platforms.

Highest and best use (paragraphs 28 and 29)

F9 Paragraph 29 states that an entity's current use of a non-financial asset is presumed to be its highest and best use, unless market or other factors suggest that a different use by market participants would maximise the value of the asset. For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the presumption that the asset's current use is its highest and best use is 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. The presumption can be rebutted even if implementation of the committed-to plan has not yet been initiated or communicated to external parties by the measurement date.

F10 For the purposes of paragraph F9, at the measurement date, the appropriate level of the entity's management is not committed to a plan to sell the asset or to use the asset for an alternative purpose if it has only commenced exploring the possibility of taking such action. For example, the following steps might, in the 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:

(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.

F11 Examples of the appropriate level of management of a not-for-profit public sector entity include a local government council and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government. The appropriate level of management for approving a plan to sell or redeploy an asset might depend on, for example, the asset's significance and the governance structure affecting the not-for-profit public sector entity. Identification of that appropriate level of management will depend on the circumstances.

F12 If the presumption that an asset's current use is its highest and best use is rebutted in accordance with paragraph F9, an entity needs to assess whether the alternative use committed to by the appropriate level of the entity's management is physically possible, legally permissible and financially feasible in accordance with paragraph 28.

F13 When applying paragraph 28(c) to a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, a 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 asset's ability to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services.

Application of the cost approach (paragraphs B8 and B9)

F14 When measuring the fair value of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows using the cost approach under paragraphs B8 and B9, the entity:

(a) assumes the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location;

(b) estimates the replacement cost of the asset subject to measurement (the subject asset) assuming that the asset presently does not exist, and uses the replacement cost of a reference asset as input. All necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date are included in the subject asset's current replacement cost; and

(c) adjusts the estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset. A reference asset could be a modern equivalent asset or a replica asset (where the utility offered by the subject asset could be provided only, or more cheaply, by a replica rather than a modern equivalent asset). A modern equivalent asset is an asset that provides similar function and equivalent utility to the subject asset, but which is of a current design and constructed or made using current cost-effective materials and techniques.

F15 For the purposes of paragraph F14(b), the entity:

(a) includes once-only costs in the replacement cost of the subject asset, that is, costs of parts of an asset not expected to actually be replaced in the future (because they are not expected to wear out) but that would need to be incurred in a hypothetical acquisition or construction of the subject asset, assuming it does not presently exist;

(b) determines, 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 the subject asset at the measurement date:

(i) costs of removal and disposal of any unwanted existing structures on land that would hypothetically be incurred unavoidably when acquiring or constructing the subject asset at the measurement date; and

(ii) 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; and

(c) uses the costs necessarily incurred in the context of the entity's expected manner of replacement in the ordinary course of operations, rather than using only the cheapest legally permitted costs to the entity. For example, where replacement of the surface of a road would necessarily, in the ordinary course of operations, occur at night rather than during daytime to minimise disruption to drivers, the more costly night-time costs should be included in the asset's current replacement cost rather than the lower daytime costs. This would occur when it is necessary for the entity to incur the higher night-time cost, that is, if replacement of the surface of the road in the daytime would be incompatible with the entity's required continuity of service.

Economic obsolescence

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

F17 When an asset described in paragraph F16 apparently has surplus capacity in view of current demand for its services, economic obsolescence is not identified for that asset if that 'surplus capacity' is necessary for stand-by or safety purposes (eg to deal with contingencies), even if it seldom or never is actively utilised.

F18 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. Consistent with paragraph F16, this would be the case regardless of whether a formal decision has been made to reduce the school building's capacity.

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

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

These examples illustrating aspects of the Australian guidance for not-for-profit public sector entities in AASB 13 complement, and have the same status as, the Illustrative Examples accompanying IFRS 13 Fair Value Measurement*, which are available on the AASB website to website users in Australia.*

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

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

IE2 Examples 1 and 2 illustrate the costs included in the current replacement cost (before deducting obsolescence) of a non-financial asset not held primarily for its ability to generate net cash inflows under the cost approach in paragraphs B8 and B9, and in paragraphs F14 and F15.

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.

	Estimated cost as at 30 June 20X2
	$'000
Design work	2,200
Earthworks	10,000
Formation	5,000
Pavement	3,000
Surfacing	2,000
Disruption of traffic (traffic control and detour costs)	1,000
Total	23,200

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 with unwanted existing structures and incurred a cost of $1,000,000 to remove those structures. Council A assesses that, 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 $1,000,000 as at 30 June 20X2).

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

<u>Once-only costs</u>

In accordance with paragraphs F14 and F15, Council A concludes that each of the estimated costs listed above (which total $23,200,000) should be included in the road's current replacement cost because that measure assumes that the road asset presently does not exist and 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 (ie traffic control and detour costs).

<u>Costs of removal and disposal of unwanted existing structures</u>

In addition, Council A includes the estimated costs of removal and disposal of unwanted existing structures at $1,000,000 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.

Consequently, Council A measures the road's current replacement cost (before deducting any obsolescence) as at 30 June 20X2 as $24,200,000 (ie $23,200,000 + $1,000,000).

Example 2 – Change in the asset's operating environment affecting the current replacement cost of a road after its initial fair value measurement

In this example, the facts of Example 1 apply, and it is also assumed that:

- during the year ending 30 June 20X3 another entity's drainage works were installed under the road;
- Council A determines that, if its road was to be replaced as at the measurement date of 30 June 20X3, 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 A's road (ie another type of intrinsically linked disruption cost) is $2,500,000;
- Council A is not part of a group of entities that prepares consolidated financial statements;
- none of the replacement costs as at 30 June 20X2 changed during the year ending 30 June 20X3 (for simplicity in this Example); and
- the effect of depreciation of the road for the year ending 30 June 20X3 is ignored (for simplicity).

<u>Current replacement cost considerations as at 30 June 20X3</u>

<u>Restoration costs for disrupted assets of another entity</u>

In addition to the unchanged replacement cost estimate of $24,200,000 for the components of that cost existing at 30 June 20X2, Council A also includes in the road's current replacement cost 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 A is not part of a group of entities that prepares consolidated financial statements, the 'same group' scope exclusion for such costs in paragraph F15(b)(ii) does not apply to Council A.

Consequently, as at 30 June 20X3, Council A measures the road's current replacement cost (before deducting any obsolescence) as $26,700,000 (ie $24,200,000 + $2,500,000). Ignoring the effect of depreciation of the road for the year ending 30 June 20X3, this represents an increase of $2,500,000 in the road's carrying amount, which is recognised as a revaluation increase in accordance with paragraphs 39 and Aus39.1 of AASB 116.

As at 30 June 20X2, Council A did not anticipate in its financial statements the cost of $2,500,000 to restore another entity's drainage works. This is because the operating environment of the road as at 30 June 20X2 did not require incurring the restoration cost if the road were replaced as at 30 June 20X2. In contrast, the change in the operating environment of the road during the year ending 30 June 20X3 – that is, the installation of new drainage works under the road – caused such restoration costs to be necessarily incurred if Council A's road was hypothetically replaced as at 30 June 20X3.

Basis for Conclusions

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

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Exposure Draft. It sets out the reasons why the Board developed the Exposure Draft, the approach taken to developing the proposals and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

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

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

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

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

Diversity and inconsistency in applying the requirements of AASB 13

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

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

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

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

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

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

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

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

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

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

Fair Value Project Advisory Panel and outreach activities in developing the Exposure Draft

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

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

Stakeholder feedback on the IPSASB's Measurement project

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

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

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

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

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

BC15 In accordance with paragraph 20 of *The AASB's Approach to International Public Sector Accounting Standards* (October 2019), in May 2020 the Board issued ITC 45 *Request for Comment on IPSASB Exposure Drafts* ED 76 Conceptual Framework Update: Chapter 7, *Measurement of Assets and Liabilities in Financial Statements* and ED 77 *Measurement*, to obtain Australian stakeholders' views on the IPSASB's proposals.

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

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

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

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

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

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

Reasons for developing the Exposure Draft

BC19 The Board considered the comments received on ITC 45 and decided to propose that the fair value measurement basis should continue to be applied when measuring the current value of all non-financial assets of not-for-profit public sector entities, including those that are not held primarily for their ability to generate net cash inflows.

BC20 Accordingly, the Board proceeded to develop additional guidance to assist not-for-profit public sector entities to apply the principles of AASB 13 more consistently in measuring their non-financial assets not held primarily for their ability to generate net cash inflows, in addressing the stakeholders' requests noted in paragraph BC7. Another key purpose of developing additional guidance is to enable application of AASB 13 in a more cost-effective manner by clarifying its application, including clarifying the extent to which preparers of financial statements need to search for information in the absence of observable market inputs.

BC21 The Board considers that it presently is not sufficiently clear under AASB 13 how to apply the following principles in measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows:

(a) the market participant assumptions to use;

(b) the circumstances in which the presumption that the asset's current use is its highest and best use would be rebutted;

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

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

BC22 Therefore, the Board decided to propose adding implementation guidance to assist not-for-profit public sector entities to apply those principles referred to in paragraph BC21. The Board observed that the proposals:

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

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

Market participant assumptions about a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs F3–F8)

BC23 Consistent with IFRS 13, when measuring the fair value of an asset under AASB 13, the objective is to estimate an exit price from the perspective of a market participant for the asset at the measurement date. Therefore, fair value assumes that a market participant's assumptions when pricing an asset are identifiable.

BC24 Some stakeholders expressed the view that, in some cases, a market participant for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is not readily identifiable. This is because the services provided by such an asset sometimes are unique; and therefore, they argued that:

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

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

BC25 In this respect, the Board noted that AASB 13 paragraph 23 states that an entity need not identify specific market participants, reflecting the focus of AASB 13 paragraph 22 on the *assumptions* that market participants would use when pricing the asset. In addition, the Board noted that, when the market selling price of an identical asset is directly observable, the entity does not need to consider what those market participant assumptions would be, because that price incorporates implicitly the assumptions that market participants would use.

BC26 When 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 (ie market participants other than the holder of the asset) would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

BC27 In light of the stakeholder comment that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are unique to the holder of the asset and another identifiable market participant for the asset would be unlikely to exist (ie the entity would be unlikely to find observable inputs for measuring the fair value of such unique assets), the Board considered that the holder of such unique assets (such as those assets listed in paragraph F8) would need to develop at least some unobservable inputs in order to measure the fair value of those assets.

BC28 AASB 13 paragraph 89 (in relation to developing unobservable inputs) states that:

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

BC29 AASB 13 paragraph 89 permits the use of an entity's own data in developing unobservable inputs. In relation to applying the principle noted in paragraph BC26, the Board proposes to:

(a) re-express the requirements of AASB 13 paragraph 89 so that an entity's own assumptions are required to be used at a starting point if some relevant information about other market participant assumptions needed to estimate the fair value of the asset is not reasonably available;

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

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

BC30 The Board considers that the re-expression of AASB 13 paragraph 89 described in paragraph BC29 would reduce the potential for confusion regarding when the search for assumptions of other market participants ends, and in turn should reduce the cost and effort required to identify which market participant assumptions to use in measuring the fair value of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. This is because:

(a) if the market selling price of an identical asset is directly observable, that price would be used to measure the asset's fair value and the entity would not need to consider what assumptions market participants are using;

(b) if the market selling price of an identical asset is not directly observable:

(i) the entity would explicitly estimate the pricing assumptions that other market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs; and

(ii) if relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, those assumptions would be used to measure fair value of the asset (albeit, in conjunction with the entity's own data, which would be the starting point where only some data of other market participants are reasonably available); and

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

BC31 In accordance with paragraphs 24(a)(iii) and 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*, the Board considered there would be merit in re-expressing the requirements of AASB 13 paragraph 89 to avoid undue cost and effort required to identify the market participant assumptions to use in measuring such assets.

Specialised asset considerations

BC32 Since most stakeholders' requests for guidance on fair value measurement pertain to non-financial assets that either have limited market inputs, or are specialised, or both, the Board considered whether to provide guidance on identifying the market participant assumptions to use when measuring specialised assets only, rather than providing guidance more broadly on all non-financial assets not held primarily for their ability to generate net cash inflows.

BC33 The Board decided not to provide guidance limited to specialised assets because:

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

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

Other considerations

BC34 The Board considered, but rejected, providing guidance on market participant assumptions based on whether a market participant other than the holder of the asset subject to measurement (the subject asset) is readily identifiable, and on identifying the entity likely to be the highest bidder for the subject asset in a hypothetical sale.

BC35 The Board made this decision after considering comments received from stakeholders in targeted outreach that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are not sold regularly and may not have market participants other than the holder of the asset. Two main concerns were raised by stakeholders regarding the approach described in paragraph BC34, namely that:

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

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

BC36 Re-expressing the requirements of AASB 13 paragraph 89 in the manner described in paragraphs F4–F7 would address these two key concerns raised by stakeholders.

The highest and best use of a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs F9–F13)

BC37 The Board noted that AASB 13 paragraph 29 states a rebuttable presumption that an asset's current use is its highest and best use. AASB 13 paragraph 29 states that "… an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset."

BC38 The Board observed that logically an asset's current use must be physically possible, legally permissible and financially feasible (referred to in AASB 13 paragraph 28). An entity need not assess whether a potential alternative use of the asset meets those three criteria in AASB 13 paragraph 28 unless the presumption that the asset's current use is its highest and best use is rebutted. The Board decided to add paragraphs F9–F11 in the implementation guidance to clarify that for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the presumption is rebutted when, and only when, at the measurement date, the appropriate level of the entity's management has committed to a plan to sell the asset or to use the asset for an alternative purpose. The Board's rationale for this proposal is set out in paragraphs BC41–BC53.

BC39 In addition, stakeholders requested the Board to provide guidance assisting not-for-profit public sector entities to apply the three concepts specified in AASB 13 paragraph 28 for identifying the highest and best use of non-financial assets not held primarily for their ability to generate net cash inflows (which has practical effect when the presumption that the asset's current use is its highest and best use is rebutted). The Board decided that, in respect of such assets, implementation guidance is needed for the 'financially feasible use' concept in paragraph 28(c) of AASB 13, but implementation guidance is not needed regarding the application of the 'physically possible use' and 'legally permissible use' concepts in paragraphs 28(a) and 28(b). The Board's views on the 'physically possible use' and 'legally permissible use' concepts are set out in paragraphs BC54–BC70.

BC40 The Board concluded that, although the 'financially feasible use' concept should apply to fair value measurements of any non-financial asset, for an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, AASB 13 paragraph 28(c) should be clarified in terms relevant to the not-for-profit public sector environment. Therefore, the Board proposed adding paragraph F13 in the implementation guidance. This is explained in paragraphs BC71 and BC72.

The presumption that an asset's current use is its highest and best use (paragraphs F9–F11)

BC41 Regarding whether the current use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is presumed to be its highest and best use, the Board observed that IFRS 13 paragraph 29 (quoted in paragraph BC37) and the related IASB Basis for Conclusions paragraph (quoted below) provide guidance:

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

BC42 However, despite that IASB text, some stakeholders requested the Board to provide additional guidance about the highest and best use of non-financial assets referred to in paragraph BC41. These stakeholders do not consider the cost incurred to search for possible alternative uses of such an asset is justified when such an asset is very unlikely to be used for a purpose other than its current use for the many cases in which the asset is:

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

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

BC43 The Board considered the request and, in respect of a not-for-profit public sector entity's non-financial asset not held primarily for its ability to generate net cash inflows, decided to provide implementation guidance specifying a rebuttable presumption that:

(a) identifies the particular circumstances in which market or other factors indicate that an alternative use to the entity's current use of the asset has become the asset's highest and best use (ie the alternative use by market participants would maximise the asset's value), consistent with the principle in AASB 13 paragraph 29 quoted in paragraph BC37; and

(b) avoids the cost and effort of such an entity searching unnecessarily for possible alternative uses of such an asset in other circumstances.

That implementation guidance is set out in paragraphs F9–F11 in Appendix F.

BC44 The Board considered that, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the asset's current use – to provide particular public services – should be presumed to maximise the value of the asset (unless that presumption is rebutted by the following circumstances). The current use presumption of such an asset is rebutted only if there is evidence that, at the measurement date, the appropriate level of management of the entity has committed to a plan to sell the asset or to use the asset for an alternative purpose. The Board considered that if a not-for-profit public sector entity has committed to a plan to sell such an asset or to use the asset for an alternative use, the entity would have determined that the alternative use will generate greater benefits than its current use. In this case, the highest and best use of that asset would be the planned alternative use (if that alternative use is physically possible, legally permissible and financially feasible in accordance with AASB 13 paragraph 28).

BC45 The Board noted that the appropriate level of management of a not-for-profit public sector entity would include a local government council and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government. The appropriate level of management for approving a plan to sell or redeploy an asset might depend on, for example, the asset's significance and the governance structure affecting the not-for-profit public sector entity. Identification of that appropriate level of management will depend on the circumstances.

Interaction with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*

BC46 Under AASB 5 paragraphs 6–8, among other conditions, a non-current asset is classified as held for sale only if the asset is available for immediate sale and its sale must be highly probable. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated.

BC47 For the purposes of paragraph F9, in respect of a non-financial asset not held primarily for its ability to generate net cash inflows, the presumption that the asset's current use is its highest and best use can be rebutted even if the conditions in AASB 5 are not met. That is, for the presumption to be rebutted, the entity's appropriate level of management need not have initiated at the measurement date an active programme to:

(a) locate a buyer; or

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

BC48 In contrast with AASB 5, under paragraph F9, it is not essential that the committed-to plan is for the sale of the asset: the plan may be to use the asset for an alternative purpose.

BC49 Some stakeholders questioned whether, for an asset for which the appropriate level of management has committed to a plan to sell the asset, it would be appropriate to require an entity to reassess the asset's highest and best use (with a potential consequence that the asset's fair value would be remeasured) if the asset has not met the classification requirement as 'held for sale' under AASB 5. They noted that, when the second event occurs, another fair value estimate would need to be determined for the asset, and expressed concern that this outcome would cause undue cost and effort. They argued that, unlike for most assets held by for-profit entities, the sale of various assets held by not-for-profit public sector entities requires a complex and lengthy approval process (sometimes requiring legislative amendment) that can cause the elapse of a significant period between when an asset satisfies the 'committing to a plan to sell the asset' condition in paragraph F9 and when the classification requirements in AASB 5 are satisfied. Therefore, they argued that this issue is a public-sector-specific issue that warrants deeming that a higher and better use than current use does not arise until the classification requirement as 'held for sale' under AASB 5 is satisfied.

BC50 The Board noted that the requirement to measure a non-financial asset's fair value based on its highest and best use is a universal requirement of IFRS 13, as adopted as AASB 13, and that disregarding (even temporarily) an alternative use by market participants that would maximise an asset's value would be incompatible with that universal requirement.

BC51 The Board considered that waiting until all the classification conditions in AASB 5 are met could deprive users of financial statements of a not-for-profit public sector entity of valuable information about an alternative use having become an asset's highest and best use, as supported by the due diligence underpinning a decision by the entity's appropriate level of management to commit to a plan to take one of those steps. For example, if an appropriate level of management commits to begin using an asset (such as equipment) for a commercial purpose (eg by leasing out that equipment) while awaiting approval of the asset's sale, it could deprive users of information about the asset's value if an entity waits until the classification conditions for being 'held for sale' in AASB 5 are met before taking into account the commitment to change the asset's use. It should be noted that if a non-financial asset's alternative use is identified as its highest and best use and the alternative use has a primary purpose of generating net cash inflows, the asset would subsequently be outside the scope of the proposed implementation guidance set out in Appendix F.

BC52 The Board noted that identifying a higher and better alternative use than the asset's current use would not necessarily cause a change in the measurement of the asset's fair value, particularly if the asset's fair value is measured at current replacement cost (ie under the cost approach). The asset's current replacement cost might not change, although the asset might provide services (or be capable of adaptation to providing services) of higher utility than those provided by the asset's current use to the entity's service recipients. However, the Board acknowledged that cost and effort might need to be incurred in establishing whether this is the case.

BC53 In asking for comment on the proposed criteria in paragraph F9 for when, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the presumption that the asset's current use is its highest and best use is rebutted, the Board seeks comments on the likely costs and benefits of that proposal.

Physically possible

BC54 As stated in AASB 13 paragraph 22, fair value measurement of an asset is based on the assumptions that market participants would use when pricing the asset. Specifically, when the presumption that an asset's current use is its highest and best use is rebutted, to identify the highest and best use of an asset, an entity takes into account the use of the asset that is physically possible, legally permissible and financially feasible.

BC55 Stakeholders requested guidance regarding whether, and if so how, physical constraints should be considered when measuring an asset's fair value. These physical constraints can be:

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

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

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

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

Naturally occurring physical constraints

BC56 The Board concluded that a naturally occurring physical constraint leading to an inability in practice (rather than hypothetically) to replace or relocate the asset, such as a marine park, does not of itself preclude measuring the asset at fair value because a fair value measurement assumes a hypothetical transaction.

BC57 However, for some marine parks and old growth forests there might be insufficient market data available to enable reliable estimates of the asset's fair value. The Board noted that AASB 116 paragraph 31 specifies that for an asset to be subsequently measured at a revalued amount, the fair value of the asset must be able to be measured reliably.

Physical constraints resulting from the entity's activities

BC58 The Board noted that some activities of the entity, such as using a parcel of land as a garbage tip, affect the physical characteristics of the asset that market participants would take into account when pricing the asset (eg using land as a garbage tip would limit the physically possible use of the land, as referred to in AASB 13 paragraph 28(a)).

BC59 In the case of cemetery land, even if the land were not legally restricted to being used only as a cemetery, the number of plots used for interred human remains would affect the cash-generating ability of the cemetery land because it reduces the number of remaining plots that a market participant could sell. This would be considered in measuring the fair value of cemetery land by reference, directly or indirectly, to the land's ability to generate net cash inflows or income.

BC60 The Board considered that any specific guidance regarding how physical constraints should be considered in estimating the fair value of an asset does not belong in principles-based Australian Accounting Standards.

Legally permissible use

BC61 Paragraph IE29 of the Illustrative Examples accompanying IFRS 13 provides the following example of legally permissible uses of a non-financial asset:

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

BC62 Consistent with the IASB's analysis in the illustrative example quoted in paragraph BC61, the Board noted that the fair value measurement of an asset:

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

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

Prohibitions on sale

BC63 AASB 13 paragraph 28(b) is silent regarding whether prohibitions on the sale of an asset are to be considered in identifying an asset's highest and best use; that paragraph only specifies that certain restrictions on the *use* of asset should be taken into account when identifying an asset's highest and best use. Some stakeholders requested guidance on the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows that the entity is prohibited from selling, and how that prohibition should be taken into account in measuring the asset's fair value.

BC64 The Board noted that the fair value of an asset is based on a hypothetical sale transaction, notwithstanding any prohibition on the asset's sale. The restrictions taken into account when determining an asset's highest and best use are those that transfer upon the asset's sale to the hypothetical market participant. Therefore, a prohibition on sale of such an asset is not a factor in the determination of its highest and best use, and consequently should be disregarded when measuring the asset's fair value.

Legal restrictions on an asset's use

BC65 Some stakeholders requested guidance regarding restrictions relating to caveats attached to land, such as where biodiversity rights have been sold through a biodiversity scheme and the land cannot be used for another purpose. The Board considered that if the caveats would remain attached to the land upon its sale to a market participant, such caveats should be considered in identifying the asset's highest and best use.

'Implied restrictions' on an asset's use

BC66 Some stakeholders have informed the Board that sometimes a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, although not subject to any legal restrictions, is subject to an 'implied restriction' limiting the asset's use to its current use – that is, where there is no legal restriction imposed on the asset but, because of social or political expectations or other factors, the not-for-profit public sector entity holding the asset would be unable to use the asset for an alternative use.

BC67 Those stakeholders consider that those assets with implied restrictions would never be sold by the entity holding them because of the legal mandates applying generally to the not-for-profit public sector entity. Therefore, they consider that the entity can only use those assets for their current use. They argued that implied restrictions over the use of an asset should be treated as substantially the same as legal restrictions referred to in AASB 13 paragraph 28(b) in identifying the highest and best use of the asset when measuring the asset's fair value.

BC68 The Board decided that the general principles in AASB 13, as described in paragraph BC62, are sufficient in determining the highest and best use of an asset subject to implied restrictions – that is, the highest and best use of an asset takes into account physical characteristics of the asset that market participants would take into account when pricing the asset, and legal restrictions on use that would be transferred to market participants in a hypothetical sale transaction. Any guidance different from this principle would be a departure from AASB 13. In addition, the Board noted that the strict criteria proposed in paragraph F9 for rebutting the presumption that an asset's current use is its highest and best use should restrict the circumstances in which the fair value of an asset with implied restrictions would be measured based on an alternative use.

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

BC69 Consistent with the Board's view noted in paragraph BC62, legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset not held primarily for its ability to generate net cash inflows that would not be transferred to market participants are not considered in fair value measurement of the asset. The Board observed that, in various cases, such legal restrictions on prices that can be charged are entity-specific restrictions (ie restrictions that are not expected to transfer to market participant buyers).

BC70 For example, a city council might provide car parking at below-market prices to provide enhanced access (and entice more visitors) to the city centre. Because a market participant buyer in a hypothetical sale of the city council's car park would not be restricted to providing car parking at below-market prices, it would price the city council's car park without regard to the discounts currently provided to patrons. Therefore, the fair value estimate of the car park should not be reduced (compared with the value determined for a for-profit entity) because of a self-imposed restriction to charge below-market prices for the use of car spaces.

Financially feasible use (paragraph F13)

BC71 The Board was also asked to clarify the application of 'financially feasible use' in AASB 13 paragraph 28(c) to non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, because those assets are not held primarily to produce an investment return. AASB 13 paragraph 28(c) refers to an asset's use that "generates adequate income or cash flows … to produce an investment return …".

BC72 The Board considered that adding the guidance in paragraph F13 is necessary to avoid the risk that AASB 13 paragraph 28(c) is interpreted to preclude measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows at an amount exceeding the present value of cash inflows generated directly by the asset. Such an interpretation could result in measurements that do not reflect faithfully the service potential embodied in those assets for which market participants would be prepared to pay in a hypothetical sale transaction. The Board noted that for many assets not held primarily for their ability to generate net cash inflows, their fair value would be measured at current replacement cost (under the cost approach), and although these assets often generate considerable cash inflows through 'indirect' sources, such as appropriations and grants, these cash inflows typically would not be included in assessments of 'investment returns' such as the cash inflows used in applying the income approach.

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

BC73 A group of stakeholders asked the Board to clarify whether, in relation to land and improvements of a not-for-profit public sector entity not held primarily to generate net cash inflows, the fair value of improvements on land should be measured at nil if it has been concluded that the highest and best use of the land used jointly with improvements is different from its current use (to provide services to the community) and the highest and best use assumes the existing improvements on the land would be demolished. The Board noted that:

(a) the IASB considered this issue in the context of for-profit entities when developing IFRS 13 (see paragraphs BC75 and BC76); however,

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

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

BC74 Therefore, the Board decided not to develop implementation guidance on this issue. In addition, the Board noted that, since receiving the stakeholder group's request for guidance noted in paragraph BC73, the Board developed the proposed rebuttable presumption in paragraph F9, which has implications for identifying the highest and best use of the land and improvements – specifically, in various circumstances, it might nullify the premise of the question (namely, that the assets' current use is not their highest and best use). Under that proposal, for an alternative feasible use of land and buildings currently used for a community purpose to be identified as the highest and best use of those assets (thus potentially imply that the buildings have a fair value of nil), it would be necessary to meet the criteria proposed in paragraph F9 for rebutting the presumption that an asset's current use is its highest and best use. If those proposed criteria for rebutting the 'current use is highest and best use' presumption are met, the discussion in paragraphs BC75–BC79 would be relevant.

BC75 In relation to this issue generally, paragraphs BC72 and BC73 of the IASB's Basis for Conclusions for IFRS 13 use an example of a factory. Paragraph BC72 states that "The IASB concluded when developing the exposure draft" [of IFRS 13] "that measuring the factory at nil would not provide useful information when an entity is using that factory in its operations. In particular, users would want to see depreciation on that factory so that they could assess the economic resources consumed in generating cash flows from its operation." Prior to finalising IFRS 13, the IASB had exposed a proposed requirement for an entity to separate the fair value of the asset group into its current use and fair value components.

BC76 However, after considering responses from its stakeholders that preparing separate valuations for each asset in the group of assets would be costly, the IASB noted in paragraph BC73 that "… when an entity uses a non-financial asset in a way that differs from its highest and best use (and that asset is measured at fair value), the entity must simply disclose that fact and why the asset is being used in a manner that differs from its highest and best use." That disclosure requirement is stated in IFRS 13 paragraph 93(i).

BC77 Therefore, when the highest and best use of land and improvements collectively within a group of assets of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is different from their current use by the entity (after applying the proposed requirement in paragraph F9 that an alternative use would be identified as highest and best use if, and only if, the appropriate level of the entity's management has committed to a plan to sell the assets or to use the assets for an alternative purpose), the entity would nonetheless conform to the general principle that each asset's fair value is based on its highest and best use (which may mean that the factory in the IASB's example would be measured at nil), but include a disclosure note explaining why the asset is being used in a manner that differs from its highest and best use, in accordance with AASB 13 paragraph 93(i).

BC78 The Board noted that AASB 13 paragraph 31(a)(iii) states that: "assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used." In relation to the question from the group of stakeholders noted in paragraph BC73, the Board noted a view that, consistent with AASB 13 paragraph 31(a)(iii), it would be inappropriate for land and its improvements to have two different highest and best use assumptions if they are used in combination to maximise value to market participants.

BC79 The Board also noted that paragraph 17 of AASB 101 *Presentation of Financial Statements* states that to achieve a fair presentation of financial statements, an entity is required to "… provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance". The Board noted a view that, if an entity considers the current value of those improvements based on their current use and periodic depreciation are important to users of financial statements, it would consider whether it should disclose this information to comply with AASB 101 paragraph 17.

Assumed location of an asset when applying the cost approach (paragraph F14(a))

BC80 This issue relates to an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows and measured under the cost approach (eg a public school or public hospital). This issue mainly concerns the fair value measurement of real property.

BC81 The Board was asked to clarify whether the location of the real property being valued should necessarily be the property's existing location, particularly in view of the principle that an asset's current replacement cost reflects replacement in the most economical manner. For example, if a facility could deliver its services equally well in a nearby location with cheaper land, the Board was asked whether it be assumed that "the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility" (as referred to in AASB 13 paragraph B9) reflects the price of the facility in the cheaper location.

BC82 Some stakeholders argued that the facility's fair value estimate should reflect the price of suitable property in a cheaper feasible location because a market participant buyer would not be willing to pay for an asset at a more expensive location, if the facility could deliver its services equally well in a nearby location with cheaper land. They argued that applying the generally accepted principle that an asset's current replacement cost is measured on an optimised basis by reference to the price of a modern equivalent asset, the modern equivalent asset would be a nearby asset in a cheaper location.

BC83 These stakeholders argued that the market value premium of property in its existing location over a suitable alternative location is a commercial element superfluous to the entity's not-for-profit (service delivery) objectives. They note that their view is consistent with the following text of The Royal Institution of Chartered Surveyors' Guidance Note *Depreciated replacement cost method of valuation for financial reporting* (November 2018):[1]

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

BC84 In contrast, some other stakeholders argued that the current replacement cost of real property should always reflect the property's existing location, rather than the price of land in a cheaper feasible site. This is because the land's characteristics include its location, and the price premium for the existing site (compared with a cheaper feasible site) could be realised through sale and reinvested in other assets used to provide services. For example, the Application Guidance included in the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17 *Property, Plant and Equipment* states that:

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

BC85 Similarly, some stakeholders argued that, from the perspective of market participants, the property in a more expensive location provides superior services. For example, an office space in a central business district location provides greater service capacity than office space in an inner suburb by having greater proximity to stakeholders and urban infrastructure and by assisting the entity to attract and retain staff. These stakeholders are also of the view that if the property's service capacity can be relocated to another location, then the highest and best use of the current property is not limited to its existing use; and therefore, should be valued at its current location, reflecting its highest and best use.

BC86 Having regard to these conflicting views, the Board noted that it could theoretically be argued that the current replacement cost of an item of real property of a not-for-profit public sector entity should be measured as follows:

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

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

   (i) the price a market participant would be prepared to pay to remove the improvements and then sell the property as a vacant site for an alternative use – reflecting the property's

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

existing location. This is because an asset's fair value can never be less than the price for which that asset could be sold at the measurement date (excluding transaction costs); and

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

BC87 However, on further deliberation, the Board observed that the approach described in paragraph BC86 would have the following disadvantages:

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

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

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

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

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

BC88 In light of the concerns in paragraph BC87, the Board concluded that the current replacement cost of an asset, including real property, of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows should be measured by assuming the asset is replaced in its existing location, even if it would be feasible to relocate the asset to a cheaper location.

Nature of costs included in current replacement cost (paragraphs F14(b)–F15)

BC89 The Board was asked to clarify which costs should be included in the current replacement cost of an asset held by a not-for-profit public sector entity when applying the cost approach under AASB 13 paragraphs B8–B9, particularly where such an asset is constructed by or on behalf of the entity (ie not replaced in a single transaction). Specifically, stakeholders requested the Board to clarify whether the following costs should (among other costs) be included in the current replacement cost of the asset subject to measurement (the subject asset):

(a) once-only costs (ie costs of parts of an asset not expected to actually be replaced in the future, because they are not expected to wear out, but that would need to be incurred in a hypothetical acquisition or construction of the subject asset assuming it does not presently exist);

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

(c) intrinsically linked disruption costs, including costs of restoring another entity's asset that would be disrupted in a hypothetical replacement of the subject asset (the nature of disruption costs is explained in paragraph BC107).

BC90 Stakeholders also requested the Board to clarify, when identifying the component costs to include in an asset's current replacement cost, whether it should always be assumed that the asset would be replaced in the most economical manner, even if the entity would, in its ordinary course of operations, be required to incur additional costs.

The overall principle

BC91 The Board noted that, consistent with International Valuation Standard IVS 105 *Valuation Approaches and Methods* (effective 31 January 2022), measuring the fair value of an asset applying the cost approach generally requires an entity to:

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

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

BC92 IVS 105 mentions that a reference asset could be a modern equivalent asset or a replica asset. Paragraph 70.5 of IVS 105 describes a modern equivalent asset as an asset "… that provides similar function and equivalent utility to the asset being valued, but which is of a current design and constructed or made using current cost-effective materials and techniques."

BC93 Paragraph 70.6 of IVS 105 states that using the reproduction cost method (ie the reference asset is a replica of the subject asset) to measure the value of the subject asset is appropriate in circumstances such as the following:

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

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

BC94 In respect of determining which costs should be included in estimating the current replacement cost of the subject asset, two main views have been expressed by stakeholders:

(a) View 1: The current replacement cost of an asset should exclude any components of the asset that will not require replacement in the future because their service capacity does not expire over time (ie once-only costs should be excluded). For example, in relation to a road, they argue that an estimate of its current replacement cost should exclude the cost of design work, earthworks and formation costs because those components do not wear out or become otherwise obsolete, and therefore do not require replacement in the future; and

(b) View 2: An asset's current replacement cost should be based on the current market buying prices the entity would need to incur at the measurement date to perform the construction work it performed when it constructed the asset (ie the nature of the costs included in the asset's current replacement cost should be based on the entity's environment when it constructed the asset rather than the entity's current environment, which affects market participants' pricing assumptions at the measurement date).

BC95 The Board concluded that neither View 1 nor View 2 fully reflects the principles of AASB 13. This is because:

(a) IFRS 13 paragraph BC30 states that the definition of fair value in IFRS 13 assumes a hypothetical exchange transaction. Therefore, the components of replacement cost included in an asset's fair value are not limited to actual replacement transactions expected to occur in the future; and

(b) AASB 13 paragraphs B8–B9 state that the cost approach to measuring an asset's fair value reflects the amount that would be required *currently* to replace the asset's service capacity. From the perspective of the market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a reference asset (as described in paragraph BC92), adjusted for obsolescence.

BC96 The Board concluded that the current replacement cost of an asset includes all necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date (and not at the asset's historical date of construction). This is because a market participant buyer of the subject asset would need to incur those costs if it acquires the subject asset at the measurement date, whether that buyer acquires the subject asset from the entity or constructs the subject asset itself. Consequently, in estimating the current replacement cost of an asset, an entity estimates all necessary costs intrinsically linked to acquiring or constructing the subject asset assuming it presently does not exist (ie the market participant buyer does not presently possess the subject asset and needs to acquire it in its entirety); therefore, the following costs (among other costs) should be included in an asset's current replacement cost:

(a) once-only costs; and

(b) costs of removal and disposal of unwanted existing structures on land (where it would be necessary for a market participant buyer to incur those costs).

BC97 The Board noted a comment made by some stakeholders that it might seem counter-intuitive, when applying the cost approach, to assume (for the purposes of a hypothetical sale) that the asset does not exist, when the asset actually exists. The Board acknowledged that the definition of fair value in AASB 13 paragraph 9 refers to the price that would be received to *sell* an asset (ie exit price). However, when the best evidence of an asset's fair value (maximising the use of relevant observable inputs) is not data about an asset's selling price or net cash inflows from use (and therefore the cost approach is applied), the asset's fair value is derived by regard to the asset's market *buying price* (often the sum of a number of purchase prices for the asset's components). In this regard, the market buying price that a market participant buyer would be prepared to pay for an asset that is the subject of measurement (ie the subject asset) is estimated by reflecting the fact that the market participant buyer presently does not possess the subject asset. Often, it would be necessary to use the pricing assumptions of the entity holding the subject asset (eg when the asset is specialised) to estimate the pricing assumptions of a market participant buyer; in that context, it is assumed that the entity does not hold the asset (as a proxy for the market participant buyer).

Once-only costs

BC98 Current replacement cost assumes hypothetical replacement or reconstruction of the asset being measured, and is not limited to costs of replacements the entity expects to incur in the future (which is a matter of budgeting rather than measurement of existing resources). To conclude otherwise would imply that the fair value of an asset measured under the cost approach would be zero if, at the measurement date, the holder of the asset expects the asset neither to be replaced at the end of its useful life nor to have components replaced during its remaining useful life. Therefore, the Board reached the view that the current replacement cost of an asset does not exclude once-only costs that market participants would expect to necessarily incur when constructing the asset, despite once-only costs not being expected to actually be incurred again in the future by the entity in relation to the subject asset.

Costs of removal and disposal of unwanted existing structures on land

BC99 Entities would need to apply judgement in the circumstances of the subject asset to determine the necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date, assuming the subject asset presently does not exist. This would include whether it would be necessary for the market participant to remove and dispose of existing structures on land in order to hypothetically construct the subject asset at the measurement date.

BC100 For example, to measure the current replacement cost of a specialised building, an entity would consider whether a market participant buyer would be able to acquire a vacant site in the area surrounding the existing location. If suitable vacant sites are available, market participants would be unlikely to pay for the current cost to demolish existing structures on the site (and, therefore, it would be unlikely that such a cost would be considered 'necessarily incurred'). Similarly, if market participants are able to acquire a suitable parcel of land with an existing structure that they could modify as necessary to create a modern equivalent asset, it would be unnecessary to remove and dispose of existing structures on land in order to hypothetically construct the subject asset.

BC101 Some stakeholders commented that the treatment of costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct the subject asset at the measurement date should be consistent with the treatment of costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located (AASB 116 paragraph 16 identifies this latter type of costs as part of the cost of an item of property, plant and equipment). Those stakeholders commented that if there is no present obligation for an entity to incur costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct the subject asset at the measurement date, such costs should not be included in an asset's current replacement cost. Some other stakeholders asked for clarification of the relationship between those costs and the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located.

BC102 The costs included in an asset's current replacement cost, as a measure of the amount a market participant buyer would be prepared to pay for the asset, represent the costs avoided by a market participant buyer as a result of the entity possessing the service capacity embodied in the subject asset. Consistent with the related comment in AASB 13 paragraph B9, the market participant buyer is prepared to pay the current amount of those costs avoided, and no more. For example, if:

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

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

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

BC103 Where the conditions in paragraphs BC102(a) and (b) are satisfied, the costs to remove and dispose of unwanted existing structures on land would be those of the typical market participant buyer. However, in the absence of reasonably available observable data about the costs saved by the market participant buyer, the entity would use its own assumptions about the removal costs it would incur if, hypothetically, those unwanted structures existed.

BC104 In contrast with costs to remove and dispose of unwanted existing structures on land, the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located are end-of-economic-life costs. The determination of whether those latter costs would merit inclusion in the asset's current replacement cost would involve an assessment of whether the market participant buyer of the subject asset would pay for those costs, which in turn would depend on whether possessing the subject asset would save the market participant buyer from having to incur those end-of-economic-life costs.

BC105 The Board considered that, in general, end-of-economic-life costs are asset-related costs that are unlikely to be avoided by the market participant buyer as a result of acquiring the subject asset. Therefore, it would generally seem logical to exclude those costs from an estimate of the subject asset's current replacement cost. The Board observed that Illustrative Example 2 accompanying AASB Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* states that, if an asset's valuation does not include an amount for these end-of-economic-life costs for which the entity has recognised a provision, the carrying amount of the asset will need to be adjusted by adding back an appropriate amount for the provision (Interpretation 1 paragraph IE7(b)). The IFRS Interpretation Committee's Basis for Conclusions on the IFRS Interpretation adopted as AASB Interpretation 1 states that the provision is accounted for separately from the valuation of the asset to ensure it is not counted twice (paragraph BC25(a)).

BC106 However, the Board also considered that the identification of whether the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located would merit inclusion in an asset's current replacement cost would depend on the circumstances, and is a matter for detailed valuation assessments. Therefore, the Board decided not to stipulate whether those costs should be included in an asset's current replacement cost.

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

BC107 The Board was asked to clarify whether the subject asset's current replacement cost should include the cost to restore another entity's asset that would be disrupted during the hypothetical construction of the subject asset (eg drainage works of another entity disrupted when replacing a road). The Board decided to develop proposed guidance on such restoration costs and other disruption costs arising upon the hypothetical construction of the subject asset; those costs are collectively termed 'disruption costs' in this [draft] Standard. Examples of disruption costs other than costs of restoring another entity's assets are costs of directing and diverting traffic (including the hire of safety barriers) and costs of employing safety officers.

BC108 The key principle underpinning the inclusion of disruption costs (including, but not limited to, costs to restore another entity's assets that would be disrupted during the hypothetical construction of the subject asset) in the current replacement cost of a subject asset is that, as specified in paragraph F14(b), to reflect the pricing assumptions of market participants, a subject asset's current replacement cost includes all necessary costs intrinsically linked to acquiring or constructing that asset at the measurement date.

BC109 The Board considered the following comments expressed by some stakeholders that it would be inappropriate to include the cost to restore another entity's asset in the current replacement cost of an asset held by the entity:

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

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

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

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

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

BC110 In relation to the concern noted in paragraph BC109(a), the Board regards such restoration costs as costs of obtaining access to the service capacity embodied in the entity's subject asset. The Board noted that such costs restore, rather than enhance, the disrupted asset and, accordingly, are confined to the consequences of acquiring or replacing the entity's subject asset.

BC111 In relation to the concern noted in paragraph BC109(b) about recognition of an increase in an asset's fair value without the entity incurring a related cost (and therefore a gain being recognised), the Board noted that these increases are examples of various increases in the market buying prices of components of assets that continue to be held by the entity and do not involve a related cost to the entity. The Board considered that a market participant would be willing to pay more for an asset due to the change in the asset's operating environment, despite the asset's service capacity to produce outputs not having improved. This is because all costs to restore another entity's asset would necessarily be incurred by a market participant if it were to acquire or construct the subject asset at the measurement date. Those additional restoration costs are necessarily incurred to obtain access to the services the subject asset is expected to generate. Similarly, a market participant would consider the costs currently avoided by possessing the subject asset: these costs are not limited to those already incurred by the entity or to restoration costs that would have been incurred to initially acquire or construct the asset.

BC112 The Board agrees with the concern noted in paragraph BC109(c) that the consolidated financial statements of the group to which the entity belongs would be overstated if both the disrupted asset and the subject asset are measured at their current replacement cost and included in the consolidated financial statements. Therefore, the Board decided that the current replacement cost of the subject asset should exclude any costs that hypothetically would be incurred to restore assets of an entity within the same consolidated group as the holder of the subject asset.

BC113 In reaching that decision noted in paragraph BC112 about the double-counting issue described in paragraph BC109(c), the Board considered whether, instead, it would be appropriate to exclude such restoration costs from current replacement cost, on the grounds of simplicity, for all non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. However, the Board decided against this approach because feedback from some stakeholders (in particular, local governments) supported including restoration costs for another entity's assets – consistent with local governments not being identified as entities included in a group of entities that prepares consolidated financial statements.

BC114 The Board acknowledged that the proposed exclusion of such restoration costs for assets of entities within the consolidated group to which the holder of the subject asset belongs would depart from the conceptual principle that an individual entity's assets are accounted for by reflecting the entity's perspective (rather than the perspective of the group). The Board considered that a more conceptual variation of the approach noted in paragraph BC112 would be to provide guidance that such restoration costs are included in an individual entity's financial statements where the entity is part of a group of entities that prepares consolidated financial statements, but eliminated on consolidation. However, in view of the cost involved in tracking such restoration costs at each measurement date, only to omit those restoration costs from the consolidated financial statements for the group, the Board considers that the costs of applying that more conceptual variation would be likely to outweigh the benefits of that approach.

BC115 The Board also considered a concern expressed by some stakeholders that including the cost to restore another entity's asset in the subject asset's current replacement cost implies that the subject asset presently exists, which contradicts the general assumption in paragraph F14(b) that the replacement cost of an asset is calculated by assuming that the asset presently does not exist. The Board disagrees with this view. The Board observed that, when acquiring or constructing an asset in a hypothetical transaction, assets of other entities may be disrupted. The fact that those disrupted assets of other entities might not have existed when the subject asset was actually acquired is irrelevant to the assumptions about a hypothetical current acquisition transaction.

BC116 The Board considered whether to omit the statement in paragraph F14(b) that estimates of the replacement cost of the subject asset assume that the asset presently does not exist, while retaining that paragraph's requirement that all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date are included the subject asset's current replacement cost. However, the Board noted that the assumption in paragraph F14(b) provides the conceptual underpinning for that paragraph's requirement: without it, that requirement would simply be a rule. The assumption links the measurement of current replacement cost to the fair value measurement objective of estimating the amount the market participant buyer would pay for the asset, since the market participant buyer is assumed not to possess any part of the subject asset when bidding for that asset.

BC117 The Board does not propose including in the subject asset's current replacement cost any costs to restore other assets of the entity that would be disrupted in a hypothetical construction of the subject asset. This is because including those costs would double count them in fair value measurements of the entity's assets. If those other assets controlled by the entity are measured under the cost approach, their current replacement cost would include all costs of constructing them (or paying another entity to construct them) in their entirety. Therefore, the sum of the current replacement costs of each of the entity's assets should exclude any restoration costs relating to the entity's own assets.

Whether calibration is needed

BC118 In relation to including in the current replacement cost of a subject asset restoration costs of another entity's assets that were not incurred on initial acquisition of the subject asset (see paragraph BC109(b)), one stakeholder requested the Board to clarify whether including in an asset's current replacement cost any costs not yet actually incurred by the entity (and therefore resulting in a higher fair value of the asset compared with the initial capitalisation of cost) would require the application of the 'calibration' techniques referred to in AASB 13 paragraph 64. The stakeholder commented that, if calibration were required, the estimate of an asset's current replacement cost would be calibrated in such a manner that the estimate reflects actual transaction prices (ie excludes any cost components not yet incurred by the entity, such as those hypothetical costs to restore another entity's assets described above). AASB 13 paragraph 64 states that:

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

BC119 The Board considered the suggestion in paragraph BC118 and decided not to propose requiring estimates of a non-financial asset's current replacement cost to be restricted to actual transactions, as an application of AASB 13 paragraph 64. This is because:

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

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

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

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

BC120 If AASB 13 paragraph 64 were to be applied to the situation described in paragraph BC118 – measuring those assets at their actual transaction price, which would be lower than its current replacement cost that includes unavoidable hypothetical costs required in paragraph F15(b) – it would appear to nullify the aim of AASB 116 paragraph Aus15.1. That paragraph requires not-for-profit entities to initially measure the cost of an item of property, plant and equipment at fair value in accordance with AASB 13 where the consideration for the asset is significantly less than fair value principally to enable the entity to further its objectives. The transaction price would apparently be the amount of consideration paid for the asset, by applying AASB 13 paragraph 64, fair value at initial recognition would equal the cost of acquisition (rendering AASB 116 paragraph Aus15.1 redundant).

BC121 In relation to paragraph BC119(b), the Board noted that paragraphs BC143–BC146 of the IASB's Basis for Conclusions on IFRS 13 indicate that the valuation adjustments involving calibration relate to measurement uncertainty, mainly in respect of financial assets and liabilities. The two circumstances identified in IASB paragraph BC145 that are not confined to financial assets and liabilities are where:

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

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

BC122 The Board considers that neither of the circumstances referred to in paragraph BC121 seems particularly applicable to the treatment of restoration costs yet to be incurred by the entity at the measurement date.

The most economical manner of hypothetical replacement

BC123 Application of the cost approach assumes implicitly a hypothetical acquisition or construction of the subject asset occurs in the most economical manner. However, stakeholders informed the Board that in many cases, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs in order to maintain an adequate quality of services to the public. Where the entity or another market participant replaces an asset, and it would necessarily incur additional costs than the cheapest legally permitted costs, the more expensive costs would be those most likely to be included in the pricing assumptions of the market participant and to be incurred in the ordinary course of operations.

BC124 Therefore, the Board decided to propose in paragraph F15(c) that, when determining the costs necessarily incurred in acquiring or constructing the subject asset at the measurement date:

(a) those costs should be based on the context of the entity's expected manner of replacement in the ordinary course of operations; and

(b) if replacing an asset in the ordinary course of the entity's operations would mean that it would be necessary for the entity to incur costs additional to the cheapest legally permitted costs to the entity, the higher costs should be included in the subject asset's current replacement cost.

Finance costs

BC125 The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include finance costs, including borrowing costs, in the fair value of an asset that is not held primarily for its ability to generate net cash inflows and is measured at current replacement cost under the cost approach if it necessarily takes a substantial period of time to get ready for its intended use (ie whether the current replacement cost of such an asset should include finance costs that would be incurred during a hypothetical construction). In particular, if a private sector entity constructs an asset on behalf of the not-for-profit public sector entity, and if finance costs were to be included in the asset's current replacement cost, some stakeholders asked for guidance on whether the private sector entity's, or public sector entity's, asset-specific borrowing rate should be used in estimating the finance costs.

BC126 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of an asset is not specific to not-for-profit entities in the public or private sector. It concluded that, in light of AASB 13 not specifying the treatment of those costs for fair value measurements by for-profit entities, it would be inappropriate to mandate a particular treatment for not-for-profit entities applying AASB 13.

BC127 The International Valuation Standards Committee (IVSC) has indicated that consideration should be given to including borrowing costs and equity costs in the fair value of property, plant and equipment. IVS 105 states:

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

BC128 The Board noted that some stakeholders argue that a not-for-profit public sector entity should exclude borrowing costs from the current replacement cost of an asset if that entity elects, under AASB 123 *Borrowing Costs* paragraph Aus8.1, not to capitalise borrowing costs into the cost of qualifying assets. Some of those stakeholders argued that including borrowing costs in an asset's current replacement cost after writing them off on initial recognition of a qualifying asset would give rise to a revaluation gain that reflects inconsistent treatment of borrowing costs at different measurement dates – which they argue would not faithfully represent a change in the asset's value. The Board notes that this is a similar concern to that noted in paragraph BC109(b) regarding restoration costs included in the current replacement cost of an asset without having been incurred during the asset's initial construction, giving rise to what some stakeholders regard as an anomalous gain.

BC129 The Board considered that the accounting policy choice regarding capitalisation of borrowing costs at the asset's initial recognition under AASB 123 is irrelevant to how those costs should be treated in subsequent measurements of an asset that necessarily takes a substantial period of time to get ready for its intended use. This is because the price that market participant buyers would pay for an asset is unaffected by accounting policies adopted in respect of that asset. The recognition of initial costs and subsequent measurement are fundamentally different processes. Therefore, there should be no presumption that the treatment of borrowing costs should be consistent for both. The Board observed that AASB 13 paragraph B4 identifies a range of circumstances in which an asset's fair value at initial recognition can differ from its transaction price, indicating that items of comprehensive income can arise from differences between the transaction price reflected in initial measurement and fair value.

Which entity's borrowing rate should be used?

BC130 The Board was also asked to provide guidance to not-for-profit public sector entities about which entity's borrowing rate should be used to measure those borrowing costs, if borrowing costs were to be included in the asset's current replacement cost. The Board considered that, for assets for which the market selling price of an identical or comparable asset is directly observable, the market approach would likely be used to estimate the asset's fair value. Consequently, for such assets, it would be unnecessary to identify which entity's interest rate to use in estimating the asset's fair value because that market selling price would implicitly include any market participant assumptions regarding borrowing and finance costs.

BC131 For assets for which the market selling price of an identical or comparable asset is not directly observable, the cost approach might be used to estimate the asset's fair value. Where the cost approach is used, if borrowing costs or other finance costs are included in the asset's fair value measurement, under the proposed general guidance in paragraphs F4 and F5:

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

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

BC132 However, in respect of the situation described in paragraph BC131(b), the Board observed that, in most cases in which the asset subject to measurement has specialised features, information about other market participants' finance costs (including borrowing costs) specific to constructing the subject asset is unlikely to be reasonably available because applicable finance costs would depend on the financial circumstances of the constructor of the asset. When information about other market participants' finance costs is not reasonably available, the holder of the asset would use its own assumptions in estimating the amount of any finance costs to include in the subject asset's current replacement cost (if the entity determines that finance costs should be included in that asset's current replacement cost).

BC133 In relation to paragraph BC130, regarding applying the market approach to measure an asset's fair value when the market selling price of a comparable asset is directly observable, the Board noted that paragraph F5(a) states that an entity would make adjustments to that market selling price for the differences between the comparable asset and the asset subject to measurement using relevant market data. However, the Board considered that any such adjustments would exclude any explicit adjustments for borrowing costs or other finance costs because:

(a) the market selling price of the comparable asset would implicitly include any market participant assumptions regarding borrowing and finance costs; and

(b) borrowing costs and other finance costs considerations are only relevant when the cost approach is applied.

Economic obsolescence (paragraphs F16–F18)

BC134 AASB 13 paragraph B9 states that obsolescence incorporated in an asset's current replacement cost includes 'external (economic) obsolescence'. Paragraph IE12(b) of IFRS 13 gives an example of economic obsolescence of a machine held for use, namely, "conditions external to the condition of the machine such as a decline in the market demand for similar machines".

BC135 An equivalent notion of economic obsolescence of an asset or facility held by a not-for-profit public sector entity is a decline in demand for the services provided by the asset or facility, such as a school. The Board was asked to provide guidance on the circumstances in which a not-for-profit public sector entity should identify economic obsolescence of assets measured at fair value using the cost approach, in light of uncertainty and diverse interpretations. In particular, the Board was asked to clarify whether an entity should identify economic obsolescence of a facility that has suffered a reduction in demand for its services before a formal decision has been made to reduce the facility's physical capacity, including a plan for when that decision will be implemented.

BC136 Some stakeholders argued that an entity should not identify economic obsolescence of a facility before a formal decision has been made to reduce the facility's physical capacity because, until then, it is highly unlikely to be clear whether – and to what extent – economic obsolescence exists. The Board noted that the primary consideration in assessing when to identify economic obsolescence is whether market participants would deduct an amount for economic obsolescence from the asset's replacement cost when pricing the asset. This would depend on the entity's circumstances, and not on whether a formal decision has been made to reduce the asset's physical capacity.

BC137 In some instances, it might be clear that market participants would deduct an amount for economic obsolescence when pricing an asset, even if a formal decision has not been made. Deferring inclusion of economic obsolescence in the measurement of the asset's current replacement cost until a formal decision is made would not result in a faithful representation of the adjustment for obsolescence required by AASB 13 paragraph B9. In addition, such deferral would not result in the best estimate of the price that market participant buyers would pay for the asset, and therefore would be inconsistent with the requirement in AASB 13 paragraph 22 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset.

BC138 The Board observed that its conclusion on this issue is consistent with the guidance on the measurement of replacement cost in the IPSASB's Conceptual Framework (paragraph 7.41 of which states that an asset's replacement cost reflects reductions in required service capacity, without mentioning a need to formally decide to reduce the asset's capacity).

BC139 The Board noted that part of the debate about the circumstances in which to identify economic obsolescence stemmed from perceptions that AASB 13 does not have regard to the temporary or cyclical nature of shortfalls in demand for services rendered by an asset when determining whether economic obsolescence exists. Therefore, the Board decided to clarify that surplus capacity of an asset that is necessary for stand-by or safety purposes should not be identified as economic obsolescence.

BC140 Increases in demand that eliminate an apparent, but illusory, overcapacity need not be long-term in nature. For example, a school in a mining town might presently appear to have overcapacity but require a higher service capacity than indicated by present enrolments, because its enrolments are cyclical due to peaks and troughs in mining activity. Such apparent overcapacity is similar to standby assets held by entities to cope with peaks in demand: such standby assets are not affected by economic obsolescence simply because they are presently inactive. The Board observed that this is consistent with the guidance in:

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

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

BC141 The Board was asked to provide guidance on whether, for assets measured at current replacement cost and affected by economic obsolescence (eg excess capacity) an entity is required to perform two valuations (one based on the existing capacity, and another based on the estimated needed capacity) in order to estimate the gross replacement cost and related accumulated obsolescence of the asset. The Board concluded that only one valuation, based on the needed capacity (eg based on a school for 100 students in the example in paragraph F18 in the implementation guidance) would be required at the measurement date.

Approaches to estimating the fair value of specific public sector assets

BC142 The Board was asked to provide guidance:

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

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

BC143 In relation to the request noted in paragraph BC142(a), the asset types on which stakeholders requested guidance include:

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

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

(b) land not held in freehold title;

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

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

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

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

BC144 The Board observed that for various of these types of assets, there does not appear to be a not-for-profit-specific aspect to the issue; therefore, issuing guidance for not-for-profit entities in relation to their application of AASB 13 could result in the guidance being applied by for-profit entities, potentially leading to their inadvertent non-conformity with IFRS.

BC145 AASB 13 paragraph 61 requires an entity to use valuation techniques that:

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

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

BC146 A majority of stakeholders who provided input to the FVM project commented that the ability to apply judgement in the circumstances in choosing among the market approach, income approach and cost approach (or a combination of those approaches) generally works well for measuring the fair value of an asset. The Board considered this comment and formed the view that Australian Accounting Standards should not limit the application of the market approach, income approach or cost approach beyond any limits in the requirements of AASB 13 paragraph 61.

BC147 Issuing the guidance requested by some stakeholders (ie specifying the approach to apply to different types of asset) would appear to conflict with the requirements of AASB 13 paragraph 61 because it might constrain entities from using the best evidence of fair value in the circumstances. In addition, AASB 13 paragraphs 62 and 63 indicate that using a combination of the market, income and cost approaches might be appropriate for various assets. Issuing guidance favouring particular approaches for particular types of assets might be incompatible with that 'combination of approaches' guidance in AASB 13.

BC148 In relation to the request for guidance on the quantum of discounts deducted for the effects of restrictions when measuring the fair value of restricted assets using the market approach (see paragraph BC142(b)), the Board noted that, for land held by not-for-profit public sector entities, the market approach is primarily applied. The Board rejected the notion of developing guidance on the quantum of discounts in relation to land for the reasons set out in paragraphs BC168 and BC169.

BC149 Further, the Board observed that most public sector entities do not determine their own accounting policies for applying the requirements of Australian Accounting Standards, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury or Finance Department (or other authority) and the Office of Local Government in each jurisdiction. In relation to the Board's conclusion not to develop guidance beyond the scope of that proposed in this [draft] Standard, if the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction. In effect, where AASB 13 requires the exercise of judgement regarding the appropriate valuation approach, the Treasury or Finance Department (or other authority) and/or the Office of Local Government may apply judgement on behalf of entities in its jurisdiction.

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

Original request from stakeholders in 2017

BC150 All land is subject to zoning restrictions, and some land may have an easement restriction. Stakeholders have informed the Board that many not-for-profit public sector entities are subject to public-sector-specific legal restrictions beyond the zoning and easement restrictions (such as legislation specific to public sector entities or directions from Ministers) prohibiting the entity from using the land and improvements on land for a purpose other than its current use. For example, a not-for-profit public sector entity might be subject to a legal restriction prohibiting it from using a hospital and the hospital land for a purpose other than as a hospital.

BC151 This section of the Basis for Conclusions (paragraphs BC152–BC170) discusses public-sector-specific legal restrictions that are expected to be transferred to other not-for-profit public sector market participants in a hypothetic sale transaction. Legal restrictions that would not transfer to other market participants in a hypothetic sale transaction are not considered in fair value measurement of an asset.

BC152 The Board noted that in many cases, the current zoning of the land would reflect the land's public-sector-specific legal restrictions, such as having a community zoning that restricts a parcel of land to be used for community purposes. However, there might be situations in which land is zoned for a commercial purpose, but the not-for-profit public sector entity holding the land is subject to legislation preventing that entity from using any of its non-financial assets for a commercial purpose.

BC153 Panel members and other stakeholders who responded to ITC 34 originally asked the Board to provide guidance on:

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

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

BC154 Stakeholders informed the Board that the fair value of some land subject to public-sector-specific legal restrictions and not held primarily for its ability to generate net cash inflows has been valued at a very low amount; sometimes a nominal amount (eg $1 for some restricted land). They questioned whether measuring such restricted land at such a low value appropriately reflects the service potential of the restricted land. This question was asked in the context of paragraph Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements* (applicable to not-for-profit entities), which states that 'future economic benefits' or 'service potential' can be described as 'the scarce capacity to provide benefits to the entity that use them'.

BC155 The Board did not form a view on whether measuring such restricted land at a low amount or nominal amount would reflect the capacity of the restricted land available to provide benefits to the holder of the land (or to provide services to the community). The Board is undertaking a project to adapt its *Conceptual Framework for Financial Reporting* (2019) for application by not-for-profit entities, including those in the public sector. The Board plans to consider the description of service potential in the context of an asset of a not-for-profit entity as part of that project. At this stage it is unclear whether that Board consideration would have implications for the measurement of restricted land.

Feedback from public sector stakeholders during outreach

BC156 After conducting wide-ranging outreach, including outreach on ITC 45, the Board noted feedback that there is not significant diversity in how the fair value of restricted land and improvements on restricted land not held primarily for their ability to generate net cash inflows are being measured. In this regard:

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

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

BC157 The views of these stakeholder groups are elaborated on in paragraphs BC158–BC168.

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

BC158 The minority of stakeholders mentioned in paragraph BC156(b) considered that the cost approach would be the most appropriate measurement technique for measuring the fair value of restricted land where an equivalent parcel of land subject to the same public-sector-specific legal restrictions is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. They also commented that if the cost approach is applied, those public-sector-specific legal restrictions would not reduce the fair value of such restricted land to an amount less than the price of equivalent land without those restrictions. This is because, if an equivalent restricted parcel of land is not obtainable in the marketplace, the entity would need to purchase an equivalent parcel of land without those restrictions to continue delivering services, and the existence of such a restriction does not affect the price of this purchase.

BC159 Those stakeholders reached this view because they interpreted that, when applying the IASB's views in IFRS 13 paragraphs BC78–BC79:

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

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

BC160 Further, those stakeholders considered that, because the land subject to public-sector-specific legal restrictions is not held primarily for its ability to generate net cash inflows, it would generally be inappropriate to apply the income approach as an alternative to the market approach and, consequently, the cost approach should be used to measure the fair value of such restricted land.

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

BC161 The majority of stakeholders mentioned in paragraph BC156(a) expressed the view that land, including land subject to public-sector-specific legal restrictions, should generally be measured using the market approach. They disagree with the view expressed by the minority of stakeholders noted in BC158 – that the cost approach should be applied in measuring such restricted land, and the fair value of such restricted land would not be lower than the price of equivalent land without such restrictions because of the effect of public-sector-specific legal restrictions, if an equivalent restricted parcel of land is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. Under the market approach, the fair value of a parcel of land should reflect any restrictions on that land, including any public-sector-specific legal restrictions, that would transfer to market participants in a hypothetical sale transaction.

BC162 This majority of stakeholders commented that although an 'equivalent' parcel of land with the same public-sector-specific legal restrictions might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence (because public-sector-specific legal restrictions often prevent an entity from selling the land), there are market transactions for other parcels of land that are suitable reference assets. Therefore, those stakeholders consider there are more relevant observable inputs for applying the market approach, rather than the cost approach, in measuring the fair value of land subject to such restrictions.

BC163 Some of the stakeholders referred to in paragraph BC162 also commented that any improvements (eg a hospital building) on a parcel of land reduce the land's service potential. They consider that improvements on land would reduce the options the not-for-profit public sector entity holder of the land has to use the land for another purpose, unless the improvements are demolished.

The Board's decision to not provide authoritative implementation guidance

BC164 Notwithstanding the interpretation of paragraphs BC78 and BC79 of IFRS 13 in paragraphs BC159 and BC160 by a minority of stakeholders, in which they concluded that the cost approach would often be appropriate in measuring the fair value of land subject to public-sector-specific legal restrictions, the Board noted that AASB 13 paragraph 61 requires an entity to select measurement techniques:

(a) that are appropriate in the circumstances;

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

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

BC165 Therefore, the Board considered that determining appropriate measurement techniques for measuring the fair value of an asset is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards. Unless there is significant diversity in applying accounting principles in practice, there is no clear case for mandating the use of a particular valuation technique in measuring the fair value of a particular type or class of assets.

BC166 Despite the debate regarding fair value measurement of land subject to public-sector-specific legal restrictions, feedback from most stakeholders in targeted outreach and most feedback on ITC 45 indicated that, in practice, the fair value of each type or class of assets affected by this issue is being measured using a largely consistent approach – that is:

(a) for land subject to public-sector-specific legal restrictions, the market approach is used (although, as noted in paragraph BC168 below, at a more detailed level, different methods are being used to calculate the adjustments to reflect restrictions); and

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

BC167 In addition, the Board noted that AASB 13 paragraph 11 states that a fair value measurement is for a particular asset; and, therefore, when measuring the fair value of an asset, the entity considers the characteristics of the asset if market participants would take those characteristics into account when pricing the asset at the measurement date, including the condition and location of the asset, as well as any restrictions on the sale or use of the asset. This would include consideration of any public-sector-specific legal restriction that would be transferred to a market participant.

BC168 Some stakeholders commented that there is diversity in practice regarding the amounts (eg percentages) of adjustments being deducted from the value of land to reflect public-sector-specific legal restrictions, and asked the Board to provide guidance to reduce that diversity. Further, some stakeholders informed the Board that different valuers use different methods in calculating the adjustments, for example:

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

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

BC169 Since the condition and location of every parcel of land are likely to differ, and the effect of public-sector-specific legal restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted and whether the land is urban, suburban or rural, the Board considered that it would neither be practical nor appropriate for Australian Accounting Standards to specify the amount of appropriate adjustments (eg in percentage terms) under the market approach to reflect the effect of restrictions that would transfer to market participants.

BC170 As noted in paragraph BC149, in deciding not to develop guidance specific to fair value measurement of land subject to public-sector-specific legal restrictions, the Board observed that if the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction.

Other measurement issues

BC171 Some stakeholders asked the Board to provide guidance regarding the following:

(a) distinguishing obsolescence from depreciation;

(b) method of depreciation;

(c) description of accumulated obsolescence;

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

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

(f) treatment of damage of an asset;

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

(h) treatment of deferred maintenance expenditure;

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

(j) curable and incurable obsolescence.

BC172 The Board noted that none of the issues in paragraph BC171 is a justifiable circumstance under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require not-for-profit-specific modifications or guidance. This is because:

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

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

BC173 The Board considered that some of those issues relate to detailed valuation assessments, and specific guidance on them should not be included in Australian Accounting Standards. The Board also considered that the treatment of many of the issues would depend on facts and circumstances, and the role of principles-based Standards does not include providing detailed guidance about the various outcomes that can arise.

BC174 In addition, the Board noted that existing AASB pronouncements include guidance addressing some issues listed in paragraph BC171. These items of guidance are noted in paragraphs BC175–BC179.

Distinguishing obsolescence from depreciation

BC175 Some stakeholders asked the Board to clarify in Australian Accounting Standards that obsolescence for fair value measurement is different from depreciation. Since AASB 13 paragraph B9 specifies that obsolescence for fair value measurement under the cost approach is different from depreciation under AASB 116, the Board decided that additional guidance is not warranted. AASB 13 paragraph B9 states that: "Obsolescence … is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives)."

BC176 The Board observed that aspects in addition to the depreciation of an asset need to be considered in measuring the fair value of an asset. AASB 13 paragraph 11 specifies that fair value measurements take into account characteristics of an asset that market participants would take into account, including, for example, the condition and location of the asset, and any restrictions on the sale or use of the asset.

Method of depreciation

BC177 Regarding comments by some stakeholders that many entities are applying the straight-line depreciation method by default, the Board considers that AASB 116 addresses this issue adequately. AASB 116 paragraph 60 states that: "The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."

BC178 In addition, the Board observed that Example 3 in the Implementation Guidance (January 2012) accompanying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* illustrates how the change in carrying value and depreciation of a property, plant and equipment (and its related deferred tax) are calculated.

Description used in disclosures of accumulated obsolescence

BC179 In relation to the requirement in AASB 116 paragraph 73(d) to disclose accumulated depreciation for each class of property, plant and equipment, some stakeholders asked whether another description than 'accumulated depreciation' is permitted for disclosing the amount of accumulated obsolescence in financial statements. In accordance with the principle in paragraph 57(b) of AASB 101 *Presentation of Financial Statements* that the use of other terms, line items or subtotals in financial statements is permitted where such presentation is relevant to the understanding of the entity's financial position or financial performance, the Board considered that using a term other than 'accumulated depreciation' to describe accumulated obsolescence would not be a breach of AASB 116.

Effective date and transition

BC180 In accordance with paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards*, the Board decided to propose that the proposed authoritative implementation guidance set out in Appendix F should be applied prospectively for annual periods beginning on or after 1 January 2024.

BC181 The Board noted that the existing Standard was initially required to be applied prospectively, consistent with IFRS 13 *Fair Value Measurement*. As stated in paragraph BC229 of the Basis for Conclusions on IFRS 13, "… the IASB concluded that a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement) ... Therefore, the IASB concluded that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate)." For the same reason, the Board considers that the proposed authoritative implementation guidance set out in Appendix F should be applied prospectively.

BC182 The Board considered that the proposed authoritative implementation guidance clarifies the requirements of AASB 13, rather than changing those requirements. In applying the implementation guidance, an entity's changing practice in how it measures the fair value of non-financial assets not held primarily for their ability to generate net cash inflows does not indicate an error had been made previously in applying the existing requirements of AASB 13.

BC183 In accordance with paragraphs 37–40 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, prospective application of the authoritative implementation guidance would require an entity to:

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

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

Voluntary restatement of comparative information

BC184 In accordance with AASB 108, prospective application of a new accounting Standard does not involve restatement of comparative amounts disclosed in any prior period presented. However, the Board noted the view that some users of a public sector entity's financial statements might find it useful if comparative information were restated to disclose the adjusted carrying amounts of affected assets, and the corresponding adjustment to each affected component of equity, as if the implementation guidance had been applied from a preceding period presented in the financial statements.

BC185 Accordingly, the Board decided to include Specific Matters for Comment (Questions 18–20) in this Exposure Draft regarding whether an option should be provided for not-for-profit public sector entities to elect to restate comparative information to the extent practicable.

BC186 Restatement of comparative information in respect of particular preceding period(s) presented might be impracticable where, for example, the implementation guidance requires the inclusion in a non-financial asset's current replacement cost particular costs that have not previously been recorded by the entity, such as:

(a) particular once-only costs; or

(b) costs of restoring the assets of another entity that would hypothetically be incurred when acquiring or constructing the subject asset at the measurement date (see paragraph F15).

BC187 The Board also noted that it would be impracticable to apply the proposed implementation guidance to information presented in respect of a particular preceding period if such application requires the use of hindsight, either in making assumptions about what management's intentions would have been in that preceding period or in estimating the amounts recognised, measured or disclosed in respect of that preceding period. AASB 108 paragraph 53 states that hindsight should not be used when adjusting amounts for a prior period.

Comparison with IFRS 13

BC188 Not-for-profit public sector entities complying with this [draft] Standard might not comply with IFRS 13 issued by the International Accounting Standards Board (IASB).

BC189 This [draft] Standard makes the following modifications in comparison with IFRS 13 (which are intended to elaborate its requirements in the public-sector context) in respect of certain non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows:

(a) the asset's current use is assumed to be its highest and best use unless 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 (paragraphs F9–F11); and

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

(i) assume that the asset will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper location at the measurement date (paragraph F14(a));

(ii) assume that the asset presently does not exist and all components of the asset need to be replaced based on its existing service capacity at the measurement date (paragraphs F14(b) and F15);

(iii) include the costs necessarily incurred in the context of the entity's expected manner of replacement in the ordinary course of operations, rather than those necessarily incurred only using the cheapest legally permitted costs to the entity (paragraph F15(c)); and

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

BC190 In addition, this [draft] Standard provides guidance for not-for-profit public sector entities in applying the ‘market participant assumptions’ (paragraphs F3–F8) and ‘financially feasible use’ concepts (paragraph F13).

BC191 IFRS 13 does not specify:

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

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

The requirements of this [draft] Standard noted in paragraphs BC189 and BC190 might not comply with IFRS 13.