Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Fair Value Measurement for NFP Public Sector Entities**	**Meeting:**	AASB September 2022 (M190)
Topic:	**Highest and best use**	**Date of this paper:**	5 September 2022
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		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider feedback on Exposure Draft

Objectives of this paper

1. In respect of the application of the **highest and best use (HBU)** concept for measuring the fair values of not-for-profit (NFP) public sector entity assets,[1] the objectives of this paper are for the Board to:

   (a) **consider** stakeholder feedback received on the proposed implementation guidance (IG) in ED 320[2] (questions 5–8 of ED 320); and

   (b) **decide** on any modifications to AASB 13 *Fair Value Measurement* for the purposes of finalising the Amending Standard.

Overview of ED responses

2. Twelve ED respondents[3] included a response to the Specific Matter for Comment (SMC) questions 5–7 regarding when the presumption that the asset's current use is its HBU should be rebutted:

Agree	Not completely agree/disagree	Disagree	No comment
2	**3**	**7**	**4**
S2–APV S15–Deloitte	S4–EY[B] S7–KPMG S12–ACAG[B]	S3–HoTARAC[A] S6–PwC[A] S8–IPA[A] S9–CA & CPA[A] S10–API[B] S13–ABS[B] S14–Liquid Pacific	S1– Cessnock City Council S5–Blacktown City Council S11–LG Government Professionals NSW S16–Tony Blefari

1 For ease of reference, unless otherwise stated, each 'asset' referred to in this paper relates to a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows.

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

3 The Board received 16 written submissions on ED 320, which have been compiled as Agenda Paper 8.7 in the supplementary folder.

[A] The respondent considers that the presumption that an asset's current use is its HBU should only be rebutted when all conditions in AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* are met. [B] The respondent considers that the presumption that an asset's current use is its HBU should only be rebutted when the asset is ready for sale, or when the sale has been formally approved.

3. Eight of the submissions included a response to SMC 8 regarding the 'financially feasible use' aspect of HBU:

Agree	Not completely agree/disagree	Disagree	No comment
7	**0**	**1**	**8**
S2–APV S3–HoTARAC S4–EY S9–CA & CPA S10–API S12–ACAG S15–Deloitte		S14–Liquid Pacific	S1– Cessnock City Council S5–Blacktown City Council S6–PwC S7–KPMG S8–IPA S11–LG Government Professionals NSW S13–ABS S16–Tony Blefari

Overview of staff recommendations

4. Based on the feedback received, staff recommend the Board:

   (a) confirms its proposal to modify AASB 13 to limit the circumstances in which the presumption that an asset's current use is its HBU is rebutted; but

   (b) amend the rebuttal point so that the presumption that the asset's current use is its HBU can be rebutted only when it is highly probable that the asset will be sold, distributed or used for an alternative purpose to its current use; and

   (c) confirm its proposal to modify AASB 13 to clarify the application of 'financially feasible use' aspect of HBU, using wording virtually unchanged from that in ED 320.

Structure of this paper

5. This paper is set out as follows:

Part A: The presumption that the asset's current use is its HBU

Section 1: Background – The proposed IG in ED 320

6. ED 320 paragraph F9 proposed that the presumption in AASB 13 paragraph 29 that an asset's current use is its HBU 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." For the Board's reference, the relevant proposed IG in ED 320 has been reproduced in the box below.

> ### 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 F9F9, 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.

7. The Board decided to propose limiting the circumstances in which the current use presumption[4] is rebutted in response to stakeholders' requests for further guidance in AASB 13 to reduce the cost incurred to search for possible alternative uses of an asset.

4 For ease of reference, hereafter the presumption in AASB 13 paragraph 29 that an asset's current use is its HBU is referred to as 'the current use presumption'.

8. Stakeholders consider that such costs are not justified when NFP public sector entities' assets are very unlikely to be used for a purpose other than their 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.[5] [ED 320 paragraph BC42]

Section 2: Overall feedback from respondents

9. Eleven of the 12 respondents who responded to SMCs 5–7 expressed support for modifying AASB 13 to limit the circumstances in which the current use presumption is rebutted. Two of those respondents provided reasons for their support:

   (a) public sector entities have made deliberate choices in using in deciding how to use their assets to best serve community needs. Therefore, valuing such assets based on their current use (until there is evidence of changing the asset's use) is appropriate [S9–CA & CPA]; and

   (b) any attempt to incorporate a different use for the asset prior to management's commitment to change its use or sell the asset would add significant cost to the valuation exercise, and open the possibility that the valuation changes significantly in future periods if the plans or expectations change. [S15–Deloitte]

10. However, in respect of assets that would be subject to disposal, 9 of those 11 respondents disagreed (at least to some extent) with the proposed timing in ED 320 for when the current use presumption is rebutted. ED 320 paragraph F9 proposed that the current use presumption 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. Those respondents considered that management's commitment alone is insufficient to conclude that there is a higher and better use for the asset at the measurement date. This issue is discussed in Section 3.

11. Five of those 11 respondents also provided comments regarding assets that would not be subject to disposal but would be subject to an alternative use. Those respondents commented that the example steps proposed in ED 320 paragraph F10 may require clarification or amendment. This issue is discussed in Section 4.

12. In contrast with those 11 respondents, S14–Liquid Pacific disagreed with having any modification to AASB 13 that would constrain identifying a higher and better alternative use of an asset.

13. Liquid Pacific is of the view that:

   (a) public sector entities would use the information presented in financial statements in making decisions about asset management and the allocation of public funds. Therefore, if an asset's fair value measurement does not reflect its market value, it would inadvertently affect an entity's assessment of the true cost of the assets being deployed

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5 The Board observed that the IASB noted in the Basis for Conclusions for IFRS 13 *Fair Value Measurement* (in paragraph BC71) that "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**." [emphasis added]

for service delivery; and

(b) "… the costs associated with the provision of community service obligations are never more transparent than when a new public sector asset is valued at less than its cost of acquisition. And, when the continuing use of a community asset is deemed not to be that asset's highest and best use."

Staff analysis

14. In developing ED 320 the Board was aware that stipulating a criterion for when a higher and better use (than the current use) of an asset may be identified could delay recognition of a change in an asset's fair value compared with the timing under the existing text of AASB 13, but considered the ensuing reduction in the cost of applying AASB 13 justifies that risk, particularly because many NFP public sector entity assets within the scope of ED 320 have only one conceivable use (ED 320, paragraphs BC42 and BC43).

15. Staff noted that there is a precedent for not attaining full compliance with IFRS 13 by public sector entities in measuring non-financial assets – the Board added a caveat in the Comparison with International Pronouncements section of AASB 1059 *Service Concession Arrangements: Grantors* stating that applying that Standard might not result in compliance with IFRS 13.[6]

16. Staff consider that, since there is a precedent for not attaining full compliance with IFRS 13 by public sector entities, limiting the circumstances in which the presumption that an asset's current use is its HBU is rebutted would not weaken the Board's general commitment to the adoption of IFRS 13 by NFP public sector entities.

Staff recommendation 1

17. Since 11 of the 12 respondents who responded to SMCs 5–7 expressed support for modifying AASB 13 to limit the circumstances in which the current use presumption is rebutted, staff recommend:

(a) proceeding with this proposal (but changing the rebuttal point, which is discussed in Sections 3–5); and

(b) adding a caveat in the "Comparison with IFRS 13" section of the Standard to state that applying the proposed modification to AASB 13 may not be compliant with IFRS 13 (in addition to stating this fact in the Basis for Conclusions).

Questions for Board members

Q1: Do Board members agree to confirm the Board's proposal to modify AASB 13 to limit the circumstances in which the current use presumption is rebutted? If not, please provide your alternative view and reasons for that view.

The remaining sections of Part A will be discussed only if the Board agrees with Question 1.

Q2: Do Board members agree with adding a caveat in the "Comparison with IFRS 13" section of the Standard to state that applying the proposed modification to AASB 13 may not be compliant with IFRS 13 (in addition to noting it in the Basis for Conclusions)?

6 Page 4 of AASB 1059 (Compiled 31 December 2021) states that "… The requirement of AASB 1059 to initially measure a service concession asset at current replacement cost in accordance with the cost approach may not be compliant with IFRS 13."

Section 3: Feedback regarding when to rebut the current use presumption – for assets subject to disposal

18. Nine of the 11 respondents who supported modifying AASB 13 to limit the circumstances in which the current use presumption is rebutted, considered that management's commitment to a plan is premature for identifying a change in the asset's HBU given the often lengthy approval processes required in government before an asset can be sold. Two of those respondents commented that:

    (a) there have been instances in which a commitment to dispose of a public sector asset changed over time; and

    (b) therefore, the proposed IG as drafted may lead to additional time and costs in the asset valuation process for the purpose of financial reporting. [S6–PwC, S15–Deloitte]

19. Those 9 respondents suggested the proposed IG should be amended so that the current use presumption is rebutted only when:

    (a) the asset is classified as held for sale or held for distribution under AASB 5 [S3–HoTARAC, S6–PwC, S8–IPA and S9–CA&CPA]; or

    (b) a formal approval has been made to sell or distribute the asset [S4–EY, S7–KPMG, S12–ACAG] or

    (c) the asset is ready for sale in the condition that management intended [S10–API; S13–ABS].

20. These respondents provided the following reasons to support their view:

    (a) sales of government assets are generally subject to a confidential tender process, and any early disclosure may risk potential information leakage [S3–HoTARAC];

    (b) in order for management to show it is 'committed' to selling the asset or using the asset for an alternative purpose, there must be evidence that a formal approval by the appropriate level of management to do so has been obtained; having a committed-to plan alone is not sufficient evidence that a higher and better use of the asset has been identified [S4–EY, S7–KPMG, S12–ACAG];

    (c) a higher and better use for the asset (than the asset's current use) is not evident until the asset is ready for sale in the condition that management intended [S3–HoTARAC, S10–API, S13–ABS];

    (d) being committed 'to a plan' is not an explicit concept that can be applied from a macroeconomic statistics perspective [S13–ABS]; and

    (e) aligning the timing of the rebuttal with AASB 5 would help reduce the judgement involved and likely disagreements between entities and auditors on whether or not the appropriate level of management has "committed to a plan to sell the asset or use the asset for an alternative purpose." [S3–HoTARAC, S6–PwC]

21. Some roundtable participants also commented that it would be difficult to determine exactly when the entity's management is considered to have become 'committed to a plan' for the purpose of rebutting the current use presumption. Some roundtable participants suggested that the Board provides guidance to:

    (a) explain the nature of any difference between a management commitment under the ED 320 proposals and a management commitment under AASB 5 (S12–ACAG also made this suggestion); and

(b) clearly distinguish which activities by management that would indicate exploration of the possibility of disposing the asset from the activities that would indicate a commitment to sell the asset exists (S7–KPMG also made this suggestion).

Those roundtable participants considered that formal approval of an asset's disposal or meeting all AASB 5 conditions would provide a more clearly identifiable time for when an asset should be measured based on an alternative use.

Section 3.1: Staff analysis of stakeholder comments – alignment with AASB 5

AASB 5 criteria

22. For an asset to be classified as 'held for sale' or 'held for distribution', under AASB 5 paragraphs 7 and 8, there must be evidence that:

(a) the asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; and

(b) the asset's sale must be highly probable, which is when all of the following conditions are met:

(i) the appropriate level of management is committed to a plan to sell the asset;

(ii) an active programme to locate a buyer and complete the plan has been initiated;

(iii) the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value;

(iv) the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except for specific conditions permitted by AASB 5 paragraph 9), and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(v) the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

The Board's previous consideration regarding AASB 5

23. When developing ED 320, the Board considered, for an asset that would be subject to disposal, whether it would be appropriate to require an entity to reassess the asset's HBU (with a potential consequence that the asset's fair value would be remeasured) if the asset has not yet met the classification requirement as 'held for sale' under AASB 5.

24. However, the Board decided not to propose aligning the timing of the current use rebuttal with the timing of when AASB 5 requirements are satisfied, on the grounds that:

(a) HBU is a universal requirement of IFRS 13 *Fair Value Measurement*, as adopted in AASB 13, and disregarding (even temporarily) an alternative use by market participants that would maximise an asset's value would be incompatible with that universal requirement;

(b) 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 HBU, 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; and

(c) 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 (which is the valuation technique for many public sector assets). 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. (ED 320, paragraphs BC50 – BC52)

Staff analysis

25. Staff consider there is a trade-off between strict adherence to the principles of AASB 13 and achieving a better balance of costs and benefits of applying AASB 13 in the NFP public sector.

26. Staff agree with the points in paragraph 24, and noted that while four respondents considered the timing of the current use rebuttal should align with the timing of when all AASB 5 criteria for classifying the asset as 'held for sale' are met, S7–KPMG argued that "the AASB 5 criteria may not achieve an accurate fair value in accordance with AASB 13 where an alternate use has been clearly identified yet no sale activity has commenced".

27. That comment from KPMG is consistent with the risk the Board noted when developing ED 320 (see paragraph 14) that applying guidance limiting the circumstances in which the current use presumption is rebutted might not result in compliance with IFRS 13. Staff consider the risk of non-compliance with IFRS 13 would probably increase if the rebuttal point is meeting all the held-for-sale-classification criteria in AASB 5. This is because meeting all those AASB 5 criteria would in various cases occur later than the rebuttal point proposed in paragraph F9 of ED 320 (a committed-to plan for disposal or redeployment).

28. However, on balance, based on the feedback received, staff consider that it would be appropriate to align the timing of the current use presumption rebuttal with the timing of when all AASB 5 conditions are met. This is because:

    (a) sometimes the plan to dispose or redeploy an asset is initiated by an entity that has control over the holder of the asset. Therefore, the holder of the asset may not have knowledge of a committed-to plan to use the asset for an alternative purpose. As mentioned by S3–HoTARAC, sales of government assets are generally subject to a confidential sale process, and the holder of the asset might not have access to that information until some time after a plan to sell the asset becomes committed-to;

    (b) having a committed-to plan alone without the evidence of the following two conditions (which are conditions in AASB 5 paragraphs 7 and 8) is unlikely to indicate that a higher and better use for the asset than the asset's current use has been identified:

        (i) the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. Staff consider that one form of evidence that an asset is available for immediate sale is that government-imposed restrictions on the sale of the asset have been removed; and

        (ii) actions required to complete the plan should indicate that it is unlikely that significant changes to the committed-to plan to dispose of the asset will be made or that the plan will be withdrawn. Staff consider this to be an important factor because several stakeholders have informed that they have experienced instances where a government's committed-to plan to dispose of an asset has changed over time;

    (c) many non-financial assets held by NFP public sector entities are specialised and do not have alternative uses – for these assets, aligning the timing of the current use presumption rebuttal with the timing of when all AASB 5 conditions are met would provide clarity of application without causing the assets to be valued based on a use other than their HBU; and

(d) the Board's main purpose of adding IG in AASB 13 (as mentioned in paragraph 7 above) is to reduce the time and effort by preparers and auditors to determine the asset's HBU, and the requirements in AASB 5 are well understood by preparers and auditors. Therefore, aligning the timing of the current use rebuttal with AASB 5 would reduce time and effort by preparers and auditors and reduce inconsistency in reporting.

Staff recommendation 2

29. Accordingly, staff recommend changing the rebuttal point from that proposed in ED 320 so that, for assets that would be subject to disposal, the current use presumption can only be rebutted when the asset is classified as held for sale or held for distribution under AASB 5.

Question for Board members
Q3: Do Board members agree with the staff recommendation in paragraph 29?
If not, please provide your alternative view and reasons for that view.

Section 4: Stakeholder feedback regarding the timing of the rebuttal of the current use presumption – for assets subject to an alternative use without disposal

30. ED 320 paragraph F10 included some example steps that may demonstrate 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.[7]

31. Those example steps that might be necessary for a committed-to plan are noted only in this section because, if Board members agree with Staff recommendation 2 in paragraph 29 (for assets that would be subject to disposal, aligning the timing of the current use presumption rebuttal with the timing of when all AASB 5 held-for-sale-classification criteria are met), those examples would become redundant for assets that would be subject to disposal.

32. Five respondents provided specific comments on those examples of steps. Comments from other respondents regarding those examples of steps were related to assets that would be subject to sale, which are addressed in Section 3 above.

33. S15-Deloitte agreed with the proposed examples of steps. They consider that those examples would be useful in informing an entity's decision as to whether potential alternative uses should be considered in determining the asset's valuation methodology.

34. S7–KPMG commented that the examples of steps may lead to confusion and inconsistent application because 'field studies' and 'initial due diligence' typically precede any decision to commit to a plan to sell the asset or use the asset for an alternative purpose. These steps indicate only that an entity has commenced exploring the possibility of taking such action and it is not uncommon for these activities to conclude that no feasible alternate use exists. In contrast, 'development of project milestones and expected timeline' typically occurs after a relevant commitment by management. Grouping of all three steps implied that the first two example steps are evidence of some commitment. S3–HoTARAC also made a similar comment that the first two steps are required to be completed prior to any commitment.

7 The examples of steps in ED 320 paragraph F10 are:
(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.

35. S7–KPMG suggested that the Board provides examples of when management is exploring the possibility of changing the use of an asset and when a commitment exists. They suggested that an indication of a commitment exists is when a Cabinet, Ministerial or Board decision has been made or where a decision to pursue a feasible alternate use has been communicated publicly following an evaluation exercise. They consider that a government's general policy that surplus assets be divested would be insufficiently specific to indicate a commitment by management for the asset's sale or redeployment.

36. S12–ACAG expressed concern that some readers may incorrectly assume that completing the three steps outlined in ED 320 paragraph F10 would be sufficient to determine whether management has a committed-to plan to sell or redeploy an asset. ACAG suggested the following changes to the IG to avoid ambiguity:

    (a) clarify that the steps taken are examples of actions that may be required to confirm that there are no significant physical, legal or financial barriers to sell or change the asset's existing use prior to obtaining approval to sell or redeploy the asset; and

    (b) make explicit that, in order for management to be committed to sell or redeploy the asset, the appropriate level of management should already have made the decision to do so.

37. In addition, S12–ACAG noted that in a public sector context, a ministerial briefing may not be an approval, and depending on the subject asset, there may need to be ministerial approval, approval by Cabinet or a Cabinet committee or completion of another process.

38. S6–PwC considered that if the criteria in AASB 5 are introduced for assets that would be subject to disposal (as discussed in Section 3), concepts similar to those in AASB 5 should be provided in respect of other assets, such as that:

    (a) it is highly probable that the use will change to a specified alternative use;

    (b) management of sufficient authority is committed to the plan;

    (c) required approvals have been obtained;

    (d) actions necessary to transition the asset indicate that it is unlikely that plans will change; and

    (e) the change in use is expected to be completed within one year.

Staff analysis

39. Staff agree with respondents' comments that more guidance than those proposed in ED 320 would be needed to determine when a higher and better use for an asset (that would be subject to redeployment (rather than disposal) has been identified.

40. Staff agree with the suggestion made by S6–PwC that, for consistency, if the Board agreed with the staff recommendation in Question 3 above – to change the rebuttal point in the Amending Standard so that, for assets that would be subject to disposal, the current use presumption can only be rebutted when the asset is classified as held for sale or held for distribution under AASB 5 – it would be appropriate for the current use presumption of an asset that would be subject to redeployment (rather than sale) to be rebutted only when conditions similar to those in AASB 5 (but excluding that a sale or distribution is highly probable) are met.

Staff recommendation 3

41. Accordingly, subject to the Board's decision on Question 3 above, staff recommend changing the rebuttal point in the Amending Standard so that, for assets that would be subject to redeployment (rather than disposal), the current use presumption would be rebutted only when conditions similar to those in AASB 5 are met – that is, when it is highly probable the asset will

be used for an alternative purpose to its current use (please refer to the staff suggested changes to the Amending Standard in Section 5 below).

Question for Board members
Q4: Do Board members agree with the staff recommendation in paragraph 41?
If not, please provide your alternative view and reasons for that view.

Section 5: Staff-suggested changes to the Amending Standard

42. In addition to staff recommendations 1–3 noted above, staff have identified four additional recommended changes to be made to the Amending Standard for the purpose of limiting the circumstances in which the current use presumption would be rebutted, as described in paragraphs 43–52 below. To assist Board members to envisage the nature of staff's recommended changes in the Amending Standard, draft modifications to AASB 13 are included in paragraph 53 for the Board's consideration.

Change 1 – Relocating the modification text about rebutting the current use presumption to the body of AASB 13, instead of presenting it as supporting implementation guidance

43. Instead of adding supporting implementation guidance, staff recommend adding Aus paragraphs to modify AASB 13 paragraph 29 for NFP public sector entities (see draft paragraphs Aus29.1 and Aus29.2 below).

44. The staff rationale is that if the Board decides to constrain the circumstances in which a higher and better use of the subject asset than its current use might be identified, this would be an amendment of AASB 13 paragraph 29 rather than additional guidance on how AASB 13 paragraph 29 should be applied in the NFP public sector.

Change 2 – Omitting the guidance in ED 320 paragraph F11 on an entity's appropriate level of management

45. S7–KPMG commented that when examples of an 'appropriate level of management' are included in a Standard (such as those proposed in ED 320 paragraph F11), it may inadvertently imply that the appropriate level of management will only be the entity's responsible Minister or the Cabinet of that government, which is not always the case (e.g. it could also be the entity's chief executive officer).

46. Staff note that the Board has not previously been requested to provide guidance on who might be considered the "appropriate level of management" referred to in AASB 5 in respect of a sale of a public sector asset. Therefore, staff consider that such guidance would not be necessary if the Board agrees with staff recommendation to align the timing of the current use presumption rebuttal with the timing of when all conditions in AASB 5 are met (or when conditions similar to those in AASB 5 are met for assets that would be redeployed).

Change 3 – Relocating the guidance about when an entity needs to consider the three aspects of HBU (physically possible, legally permissible and financially feasible)

47. S12– ACAG commented that consideration of physically possible, legally permissible and financially feasible (as set out in paragraph 28 of AASB 13) is necessary as part of the decision/approval made by the appropriate level of management to sell or change the asset's use.

48. Staff observed that the consideration of these three aspects (albeit not in the context of identifying an asset's HBU) are implicit in AASB 5. That is, for an asset's sale to be completed within one year from the date of classification as held of sale under AASB 5, the sale must be

considered physically possible, legally permissible and financially feasible. Therefore, staff do not consider it necessary to state explicitly these implicit principles of AASB 5 if the Board agrees with the staff recommendation in Question 3 to align the timing of the current use rebuttal with the timing of when all AASB 5 held-for-sale-classification criteria are met.

49. However, for assets that would be redeployed (rather than disposed of), it would be useful to clarify that these three aspects need to be considered in order to rebut the current use presumption. Therefore, staff recommend relocating the guidance in ED 320 paragraph F12 about when an entity needs to consider the three aspects of HBU so that an NFP public sector entity is required to determine these aspects as part of identifying whether the current use presumption is rebutted (see draft paragraph Aus29.2(b)(i) below).

Change 4 – Adding an Aus paragraph to clarify the disclosure requirement in AASB 13 paragraph 93(i)

50. AASB 13 paragraph 93(i) requires an entity to disclose in the financial statements, "… for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use."

51. S12–ACAG noted that one of its jurisdictions recommended that the Board clarifies that the provisions in paragraph F9 of ED 320 (that the asset's current use is presumed to be its HBU unless rebutted) is also applicable to the disclosure requirement in AASB 13 paragraph 93(i) to avoid negating the benefits of not needing to identify hypothetical situations of alternative HBU.

52. Staff consider that applying AASB 13 paragraph 93(i) would not require disclosures where the current use presumption is not rebutted. However, since feedback suggests this point is not sufficiently clear, staff recommend modifying AASB 13 so that it is unambiguous that this disclosure is only required for assets for which the current use presumption is rebutted (see draft paragraph Aus93.2 below).

Draft modifications to AASB 13

53. Draft modifications to AASB 13 are included below for the Board's consideration.

Amendments to AASB 13

Paragraphs Aus29.1, Aus29.2 and Aus93.2 are added. Paragraphs 29 and 93(i) are not amended but are included for reference.

Highest and best use for non-financial assets

…

29 Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, 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.

<u>Aus29.1</u> <u>Notwithstanding paragraph 29, 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 can only be rebutted when it is highly probable that the asset will be sold, distributed or used for an alternative purpose to its current use.</u>

Aus29.2 For the purposes of paragraph Aus29.1, it is highly probable that the asset will be:

(a) sold or distributed when is classified as held for sale or held for distribution in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*; and

(b) used for an alternative purpose to its current use when all of the following conditions are met:

(i) the alternative purpose for the asset is physically possible, legally permissible and financially feasible in accordance with paragraph 28;

(ii) the appropriate level of management is committed to a plan to change the usage of the asset to that alternative purpose, and an active programme to complete the plan has been initiated;

(iii) the asset is immediately available to be used for the alternative purpose in its present condition;

(iv) any approvals required to change the asset's usage have been obtained;

(v) actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(vi) the change in the asset's use is expected to be completed within one year from the measurement date.

…

Disclosure

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Standard) in the statement of financial position after initial recognition.

…

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

…

Aus93.2 For the purposes of paragraph 93(i), 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 is presumed to be its highest and best use, unless rebutted in accordance with paragraph Aus29.1.

Questions for Board members

Q5: In respect of the changes staff have identified (as described in paragraphs 43–52), do Board members agree with:

(a) Change 1 – to relocate the modification text about rebutting the current use presumption to the body of AASB 13 instead of presenting it as supporting implementation guidance;

(b) Change 2 – to omit the guidance proposed in ED 320 paragraph F11 about an entity's appropriate level of management;

(c) Change 3 – for assets that would be redeployed (rather than disposed of), to add a requirement in AASB 13 regarding the three aspects of HBU in paragraph 28 of AASB 13 so that an NFP public sector entity is required to determine whether the proposed alternative purpose for the asset is physically possible, legally permissible and financially feasible as part of identifying whether the current use presumption is rebutted; and

(d) Change 4 – to add an Aus paragraph to clarify the disclosure requirement in AASB 13 paragraph 93(i)?

Q6: Do Board members have any comments on the draft text to be added to the Amending Standard?

Part B: The 'financially feasible use' aspect of HBU

54. AASB 13 paragraph 28(c) states that "A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) **to produce an investment return** that market participants would require from an investment in that asset put to that use." [emphasis added]

55. The Board proposed the following modification to AASB 13 (in ED 320 paragraph F13) regarding the 'financially feasible use' aspect of HBU. This was in response to stakeholder requests to clarify the application of this concept for NFP public sector entities' assets that are not held primarily to produce an investment return.

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.

56. Of the 8 respondents who included a response to SMC 8 regarding the 'financially feasible use' aspect of HBU, 7 agreed with the proposal and 1 respondent (S14–Liquid Pacific) disagreed.

57. Two respondents provided reasons for their support of the proposed modification:

(a) S9–CA & CPA expressed agreement that if an entity would be willing to invest in the service capacity of the asset, this amounts to a recognition that there is ongoing value of that asset's service potential that it is financially feasible to support.

(b) S12–ACAG commented that the proposed modification is consistent with how financially feasible is assessed in the public sector and paragraph Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements*, which states that "… future economic benefits is synonymous with the notion of service potential …".

58. S14–Liquid Pacific disagreed with the proposed modification and commented that introducing non-financial influences into the concept of financial feasibility significantly distorts the meaning of financial feasibility. S14–Liquid Pacific considers that financial feasibility is the possibility an asset might provide a commercial return on its construction and/or continuing use or in an alternative use, where the financial return is benchmarked in markets. The other two aspects of HBU, physically possible and legally permissible, are the necessary and adjustable variables to finding the highest financial return. It is recognised the public sector does not necessarily make investment decisions based upon the concept of HBU. However, users of financial statements should be provided the opportunity to identify when this occurs.

Staff analysis

59. AASB 13 paragraph 28(c) uses the phrase "a use of the asset … generates adequate income or cash … to produce an investment return" and since many NFP public sector entity assets are held to provide public services that do not generate much income or cash, without any

modification to AASB 13 it may inadvertently be interpreted that none of the public sector uses of these assets would be considered financially feasible; and consequently that the fair value of such assets should be based on an alternative commercial use. Staff consider that, consistent with the Board's views set out in paragraph BC72 of ED 320:

(a) for an NFP public sector entity to invest in such an asset, it would consider 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, rather than the amount of cash flows capable of being generated from use; and

(b) basing fair value measurement of an asset within the scope of ED 320 on the cash flows generated directly by that asset could result in measurements that do not reflect faithfully the service potential embodied in the asset for which another NFP public sector market participant would be prepared to pay in a hypothetical sale transaction.[8, 9]

Staff recommendation 4

60. Staff recommend:

(a) proceeding with the Board's proposal to modify AASB 13 to clarify the application of 'financially feasible use' aspect of HBU; but

(b) relocating the modification text to the body of AASB 13 if the Board agrees in Section 5 of Part A to relocate the other HBU-related modifications to the body of the Standard rather than as supporting implementation guidance.

61. The box below includes marked-up text showing staff's recommended change to the drafting of the modification to AASB 13 regarding the 'financially feasible use' aspect of HBU.

~~F13~~ <u>Aus28.1</u>	~~When applying paragraph 28(c) to~~ <u>Notwithstanding paragraph 28(c), for</u> 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.

Questions for Board members

Q7: Do Board members agree to confirm the Board's proposal to modify AASB 13 to clarify the application of the 'financially feasible use' aspect of HBU?

Q8: If so, do Board members agree to relocate the NFP guidance to the body of AASB 13 instead of presenting it as supporting implementation guidance?

Q9: Do Board members have any comments on the draft guidance on 'financially feasible use' to be added to the Amending Standard?

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8 The notion of fair value in IFRS 13 (and AASB 13) assumes a hypothetical exchange transaction (IFRS 13 paragraph BC30) rather than being based only on observed actual sales or (using the income approach) actual direct cash inflows from use.

9 The IASB noted in IFRS 13 paragraph BC78 that, in respect of specialised assets, "the market participant buyer steps into the shoes of the entity that holds that specialised asset". That is, the fair value of a specialised asset of an NFP public sector entity reflects the amount another NFP public sector market participant would be prepared to pay for that asset.