Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Fair Value Measurement for Not-For-Profit Entities**	**Meeting:**	AASB November 2021 (M184)
Topic:	**Draft modifications to AASB 13**	**Date of this paper:**	26 October 2021
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		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider draft fair value guidance

Objectives of this paper

1. The objectives of this paper are for the Board to:

   (a) consider draft modifications to AASB 13 *Fair Value Measurement* staff prepared to address specific requests from not-for-profit (NFP) public sector stakeholders, and **make preliminary decisions** about the content of its forthcoming Exposure Draft (FVM ED); and

   (b) **decide** whether the FVM ED should be applicable to NFP entities in the public sector alone or also in the private sector.

Introduction and summary of staff recommendations

2. The subject of discussion of this paper is non-financial assets of NFP public sector entities held primarily for their service capacity.[1] **For ease of reference in this paper, unless specified otherwise, 'assets' (including 'specialised assets'), refer to 'non-financial assets of NFP public sector entities held primarily for their service capacity'.**

3. Consistent with the staff recommendation in Section 8 of this paper regarding the entities to which the Exposure Draft should apply, the draft guidance in this paper is not drafted to apply to NFP entities in the private sector.

4. As mentioned in Agenda Paper 3.1, staff resumed work on developing guidance (including possible modifications to AASB 13) on fair value measurement issues on which NFP public sector stakeholders requested guidance. The draft guidance included in this paper has a slightly different scope from the scope of the working draft FVM ED considered by the Board in 2019–20. The reasons for the change in scope are outlined in the Appendix. The Appendix also includes a high-level summary of the tentative decisions the Board made in 2019–20 on topics

1 This phrase has the same meaning as the following phrase used in para. Aus5.1 of AASB 136 *Impairment of Assets* – "assets not held primarily for their ability to generate net cash inflows".

it decided to address in the FVM ED as well as recapitulation of the feedback received during the project.

Basis of staff recommendations for modifying AASB 13

5. Staff categorised the measurement issues addressed in this paper into seven topics, as set out in the Sections 1–7 in this paper. Of these:

   (a) Section 1 discusses the highest and best use concepts in the context of NFP public sector entities;

   (b) Section 2 discusses fair value measurement of specialised assets; and

   (c) Sections 3–6 discuss aspects of the application of the cost approach in AASB 13.

6. In light of:

   (a) most public sector entities measuring their non-financial assets at fair value;

   (b) the prevalence and magnitude of specialised assets in the NFP public sector; and

   (c) the extensive use of the cost approach in AASB 13 by NFP public sector entities,

   staff consider it appropriate to provide public-sector-specific guidance[2] on those topics under the *AASB Not-for-Profit Entity Standard-Setting Framework* and the AASB *Due Process Framework for Setting Standards* (Due Process Framework).

Summary of staff recommendations

7. The following Table summarises the staff recommendation in each section.

Section	Staff recommendations
Section 1: Highest and best use assessment for any assets held primarily for their service capacity	Modifying AASB 13 para. 28(c) to propose that, for a non-financial asset of an NFP public sector entity held primarily for its service capacity, a use is financially feasible if it generates a sufficient return – in the form of goods or services for the community – that it would be rational for market participants (including NFP public sector entities) to invest in the asset's service capacity.
Section 2: Identifying the characteristics of market participants and the highest and best use of a specialised asset	Including authoritative implementation guidance to propose that for a specialised asset of an NFP public sector entity: (a) if a market participant is not readily identifiable for a specialised asset, the market participant is presumed to be another NFP public sector entity having identical characteristics and service delivery objectives to those of the entity holding the specialised asset. That is, in the absence of better information about the characteristics of market participants, and consequently the assumptions they would make when pricing such specialised assets, the characteristics of the holder of the specialised asset and the assumptions it would make should be used in measuring the fair value of such specialised assets; and (b) the presumption that the current use of the asset is its highest and best use is rebutted when, and only when, there is

2 Para. 30 of the *AASB Not-for-Profit Entity Standard-Setting Framework* states that modifications to IFRS Standards may include amending measurement requirements via 'Aus' paragraphs and adding specific guidance and examples in a separate Appendix to improve ease of use and consistency of application.

Section	Staff recommendations
	evidence that the entity has committed to a plan to use the specialised asset for an alternative purpose.
Section 3: Borrowing costs under the cost approach	Including authoritative implementation guidance to propose that, for an asset measured under the cost approach: (a) When measuring the current replacement cost of a self-constructed asset of a not-for-profit public sector entity held primarily for its service capacity, the entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset. (b) If a not-for-profit public sector entity includes borrowing costs in the fair value of a self-constructed asset measured at current replacement cost, the borrowing rate used to measure those borrowing costs is, subject to (c), the borrowing rate of market participants. (c) For a specialised asset of an NFP public sector entity held primarily for its service capacity, if a market participant is not readily identifiable, the borrowing rate used is: (i) that entity's borrowing rate for such an asset; or (ii) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs.
Section 4: Nature of component costs (other than borrowing costs) to include in an asset's current replacement cost (CRC)	Including authoritative implementation guidance to propose that an asset's CRC is calculated on the assumption that the asset does not presently exist. Therefore, all necessary costs intrinsically linked to acquiring the asset at the measurement date should be included, including any make-good costs arising from disturbing another entity's asset when replacing the asset.
Section 5: Assumed location of an asset measured under the cost approach	Including authoritative implementation guidance to propose that, under the cost approach, the NFP public sector entity assumes the real property will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper site.
Section 6: Economic obsolescence under the cost approach	Including authoritative implementation guidance to propose that economic obsolescence should not be: (a) identified if the asset has apparent 'excess capacity' that is temporary or occurs cyclically; and (b) limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity.
Section 7: Approaches to estimating the fair value of certain assets	Documenting in the Basis for Conclusions the Board's reasoning for not specifying: (a) a particular measurement technique to apply in measuring the fair value of a particular type of asset; (b) whether to deduct discounts from the market value of unrestricted assets when measuring the fair value of restricted assets; and (c) where discounts are deducted, what the amounts of those

Section	Staff recommendations
	discounts should be.
Section 8: Confirming the scope of the FVM ED	Changing the scope of the FVM ED from working drafts considered by the Board in 2019–20, as follows: (a) the FVM ED should propose modifications to AASB 13 regarding market participants and the highest and best use of specialised assets; (b) the FVM ED should not provide guidance specifically on how to measure restricted assets, including restricted land and restricted concessionary ROU assets; (c) defer consideration of whether to provide additional guidance on how to measure the fair value of concessionary ROU assets until after considering the outcomes of the concessionary leases part of the IPSASB's Leases project; and (d) as a consequence of (c), the scope of the FVM ED should be limited to NFP public sector entities.

Please note, to reduce repetition in the paper, staff analysis for each topic is elaborated in detail in the draft BC paragraphs of each section.

Section 1: Highest and best use assessment for any assets held primarily for their service capacity

Requirements in AASB 13

8. AASB 13 specifies that the fair value of an asset considers the characteristics of the asset that market participants would take into account when pricing the asset at the measurement date (AASB 13 para. 11). In addition, AASB 13 requires the fair value of an asset to be measured based on its highest and best use; AASB 13 para. 29 specifies that an asset's highest and best use is determined from the perspective of market participants. Therefore, identifying the perspective of market participants is an overarching aspect of measuring an asset's fair value.

9. In relation to measuring an asset's fair value based on its highest and best use, AASB 13 paras. 28–29 set out the following requirements [emphasis added]:

> 28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:
>
> (a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).
>
> (b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).
>
> (c) 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.

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.

10. The discussion in Section 1 relates to all non-financial assets held by NFP public sector entities primarily for their service capacity, and not only to specialised assets. Highest and best use of a specialised asset is discussed in Section 2.

Physically possible and legally permissible

11. ACAG has requested guidance regarding the 'physically possible' and 'legally permissible' considerations in order to identify the highest and best use of non-financial assets held by NFP public sector entities primarily for their service capacity. Those requests and staff recommendations are documented in paragraphs BC1–BC18 below.

'Implied restrictions on use'

12. In targeted outreach activities, some stakeholders requested the Board to develop guidance about 'implied restrictions' limiting the use of an asset to its existing use – where there is no legal restriction imposed on the asset but, because of community expectation or other factors, the NFP public sector entity would be unable to use the asset for an alternative use.

13. Those stakeholders consider that, due to the legal mandates applying generally to the NFP public sector entity holding the assets, the entity can only use those assets with implied restrictions for their existing use and would not be able to sell those assets. They are of the view that implied restrictions over the use of an asset are substantially the same as legal restrictions and should therefore be treated similarly in identifying the highest and best use of the asset in fair value measurements of those assets.

14. They requested that the Board develops guidance indicating that implied restrictions over the use of an asset should be taken into account in assessing a non-financial asset's highest and best use, either by:

(a) extending the 'legal restriction' principle in AASB 13 para. 28(b); or

(b) treating implied restrictions over use as physical characteristics of assets described in AASB 13 para. 28(a) (because they often stem from the unique location of an asset, i.e. the asset provides a situation-specific cultural or other service).

15. Staff consider that such guidance would be a departure from AASB 13. Staff's analysis is expressed in paragraphs BC13–BC16 below.

Financially feasible use

The Board's tentative decision

16. In November 2019, the Board tentatively decided to exclude 'financially feasible use' from the factors to consider when identifying the highest and best use of non-financial assets held by NFP public sector entities primarily for their service capacity and measured at current replacement cost. This tentative decision reflected another tentative decision of the Board, namely, to propose mandating the measurement of the fair value of certain restricted assets at their current replacement cost (CRC).

17. At the time, the Board considered that the phrase "generates adequate income or cash flows … to produce an investment return" in AASB 13 para. 28(c) could preclude measuring an asset at its CRC, if the present value of cash inflows generated directly by the asset was less than the asset's CRC. The Board noted that one may argue that it would not be considered 'financially feasible' to measure an asset at its CRC, if the asset does not produce an investment return that

market participants would require from an investment in that asset put to that use.

Stakeholder feedback

18. The Board included a Specific Matter for Comment (AASB SMC 4) in ITC 45[3] asking whether stakeholders agree with the Board's tentative view "… that the 'financially feasible use' aspect of the asset's highest and best use should not be applicable to measuring restricted operational assets of NFP entities when an equivalent restricted asset is not obtainable in the marketplace for a price supported by observable market evidence".

19. Of the four respondents who commented on this matter, APV and ACAG agreed, and API and HoTARAC disagreed, with removing the 'financially feasible use' aspect of the asset's highest and best use. (The full names of these respondents are noted in paragraph A5 of the Appendix.) Even though AASB SMC 4 specifically asked about certain restricted assets, the comments from two respondents were related generally to specialised assets and not limited to restricted assets.

20. ACAG did not specifically explain in its comments on AASB SMC 4 why it agreed with the removal of the 'financially feasible use' aspect of an asset's highest and best use. APV explained that 'financially feasible use' would not be applicable to many public sector assets because the provision of many public services is rarely seen as financially feasible from the perspective of a commercial business.

21. API considers that 'financially feasible use' should be retained for identifying an asset's highest and best use, but considers that clarifications might be required to explain how this concept applies to assets held by NFP entities that do not generate financial returns but have a community obligation to provide a service to the public.

22. HoTARAC also considers that 'financially feasible use' should be retained when identifying an asset's highest and use. It commented that:

> "While most restricted operational assets do not generate a full financial return, any use of restricted operational assets should be financially feasible, i.e. should make economic sense in terms of comparing resources expended with service delivery objectives achieved. In the context of the public sector, HoTARAC does not believe financially feasible means profit-making, and financial feasibility is a necessary criterion when logically considering the highest and best use."

23. After considering the stakeholders' comments, staff recommend that, instead of proposing to remove 'financially feasible use' for NFP public sector entities in identifying an asset's highest and best use, the Board should propose to modify AASB 13 para. 28(c) in a manner that captures the HoTARAC comment quoted above. Therefore, staff recommend adding a proposed 'Aus' paragraph modifying the phrase "generates adequate income or cash flows … to produce an investment return" in AASB 13 para. 28(c) to reflect the NFP public sector environment. Staff drafted para. Aus28.1 and paragraphs BC19–BC22 for the Board's consideration.

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3 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*

Highest and best use

Draft amendment to AASB 13 para. 28(c)

Aus28.1 Notwithstanding paragraph 28(c), for a non-financial asset of a not-for-profit public sector entity held primarily for its service capacity, a use is financially feasible if it generates a sufficient return – in the form of goods or services for the community – that it would be rational for market participants (including not-for-profit public sector entities) to invest in the asset's service capacity.

Draft Basis for Conclusions

General principles regarding physical constraints and legal restrictions

BC1 As stated in AASB 13 para. 22, fair value measurement of an asset is based on the assumptions that market participants would use when pricing the asset. Specifically, when identifying the highest and best use of an asset:

(a) AASB 13 para. 28(a) requires consideration of physical characteristics of the asset that market participants would take into account when pricing the asset. This would include any physical constraints that a market participant would take into account when pricing the asset (e.g. contamination of a property); and

(b) AASB 13 para. 28(b) requires consideration of any legal restrictions on the use of the asset that market participants would take into account when pricing the asset. Similarly, as noted in paragraph BC2, the IASB's Illustrative Examples accompanying IFRS 13 demonstrate that a restriction over the use of an asset should be taken into account in a fair value measurement of that asset if, and only if, the restriction would transfer to market participants in a hypothetical sale transaction. When the restriction would transfer to market participants in a hypothetical sale transaction, it is regarded as a characteristic of the asset that market participants would take into account when pricing the asset.

BC2 Para. IE29 of the Illustrative Examples accompanying IFRS 13 provides the following example: "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)."

BC3 Consistent with the IASB's analysis in the abovementioned illustrative example, the Board noted that the fair value measurement of an asset would:

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

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

Physically possible

BC4 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 (e.g. marine parks) and old growth forests (e.g. national parks), where both examples are 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 a cheaper location should the entity be required to 'replace the service potential' embodied in the cemetery.

Naturally occurring physical constraints

BC5 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.

BC6 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 *Property, Plant and Equipment* para. 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 reliably measured.

Physical constraints as a result of the entity's activities

BC7 The Board noted that some activities of the entity, such as using a parcel of land as a garbage tip, affects the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. using land as a garbage tip would limit the use of the land that is physically possible, as referred to in paragraph 28(a) of AASB 13).

BC8 In the case of cemetery land, if the land were not legally restricted to be 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.

BC9 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.

Prohibitions on sale

BC10 AASB 13 para. 28(b) is silent on 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 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 held primarily for its service capacity that the entity is prohibited from selling, and how that prohibition should be taken into account in measuring the asset's fair value.

BC11 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.

Restrictions on use

BC12 Stakeholders also 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 use'

BC13 Stakeholders have informed the Board that sometimes a non-financial asset of a not-for-profit public sector entity held primarily for its service capacity, while not subject to any legal restrictions, is subject to an 'implied restriction' limiting the use of an asset to its existing use – where there is no legal restriction imposed on the asset but, because of community expectation or other factors, the not-for-profit public sector entity holding the asset would be unable to use the asset for an alternative use.

BC14 They 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 existing 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 para. 28(b) in identifying the highest and best use of the asset in the asset's fair value measurement.

BC15 The Board decided that the general principles in AASB 13, as described in paragraph BC1, 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 that is different to this principle would be a departure from AASB 13.

BC16 The Board also noted that if an asset subject to implied restrictions on use is specialised, in accordance with paragraph F2, the asset's current use is presumed to be its highest and best use, unless there is evidence that, at the measurement date, the entity has committed to a plan to use the specialised asset for an alternative purpose.

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

BC17 The Board noted that, in various cases, legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset held primarily for its service capacity are entity-specific restrictions that would not be transferred to market participants.

BC18 For example, a not-for-profit public sector entity operating a public hospital may have legal restrictions on the price it may charge for providing health services. This pricing restriction would be assumed not to transfer to market participants if a private sector buyer of a hospital facility would not be subject to that pricing restriction. In this case, the fair value measurement of the hospital facility would not take into account that pricing restriction, because it would not transfer to market participants.

Financially feasible use

BC19 The Board has also been requested 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 held primarily for their service capacity, particularly because those assets are not held primarily to generate net cash inflows or to produce an investment return. AASB 13 paragraph 28(c) refers to an asset that 'generates adequate income or cash flows to produce an investment return'.

BC20 The Board concluded that, although the principle of an asset's use being 'financially feasible' should apply to fair value measurements of any non-financial asset, for non-financial assets of not-for-profit public sector entities held primarily for their service capacity, AASB 13 paragraph 28(c) should be re-expressed in terms relevant for the not-for-profit public sector environment.

BC21 The Board considered the amendment in paragraph Aus28.1 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 held primarily for its service capacity 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 some assets held primarily for their service capacity generate considerable cash inflows through 'indirect' sources, such as appropriations and grants, but these cash inflows typically would not be included in assessments of 'investment returns'.

BC22 In the context of a non-financial asset of a not-for-profit public sector entity held primarily for its service capacity, the Board considers that a market participant's ability to generate economic benefits is not limited to the amount of net cash inflows it could generate directly (e.g. user charges), but also includes the following potentially overlapping benefits:

(a) the net cash inflows that the asset could generate indirectly through financial support (e.g. in the form of rates, taxes, grants and appropriations); and

(b) the ability to use the asset to provide needed goods or services to beneficiaries.

Questions for Board members

Q1: Do Board members agree with the staff recommendation that, instead of removing the applicability of the 'financially feasible use' principle in AASB 13 para. 28(c) to assets held by NFP public sector entities primarily for their service capacity, the Board should propose to modify AASB 13 para. 28(c) to express that principle in terms relevant for the NFP public sector environment?

Q2: Do Board members agree with the content of draft para. Aus28.1?

Q3: If Board members disagree with the staff recommendation in Q1, which alternative do Board members propose regarding stakeholders' concern that the phrase "generates adequate income or cash flows … to produce an investment return" in AASB 13 para. 28(c) does not appear appropriate for many NFP public sector assets held primarily for their service capacity and not for their ability to generate net cash inflows?

Q4: Do Board members agree that the FVM ED should not include guidance that implied restrictions over the use of non-financial assets should be treated in the same way as legal restrictions, for the reasons discussed in paragraphs 12–15 and BC13–BC16?

Q5: Do Board members agree with the content of draft paragraphs BC1–BC22?

Section 2: Identifying the characteristics of market participants and the highest and best use of a specialised asset

Guidance requested

24. In 2019–20, a key focus of the FVM project was on the fair value measurement of restricted assets. However, in recent stakeholder discussions and the responses received on AASB ITC 45, staff noted that the measurement issues stakeholders are commenting upon are not limited to restricted assets. Rather, the issues being commented on relate to fair value measurement of specialised assets. Stakeholders specifically requested the Board consider providing guidance on:

    (a) identifying the highest and best use of such specialised assets (addressed in paragraphs F2 and BC28–BC33);

    (b) the perspectives of market participants about various specialised assets (addressed in paragraphs F1and BC34–BC37); and

    (c) the implications of those perspectives for identifying the interest rates to apply in estimating the current replacement cost (CRC) of such specialised assets, if borrowing costs are included in an asset's CRC (addressed in Section 3 of this paper).

25. The majority of these stakeholders commented that:

    (a) in most cases, the services a specialised asset of an NFP public sector entity provides are unique to a government and there would not be another government or another NFP entity that would provide such services. Therefore, they argued, there would not be another market participant for most specialised assets held by NFP public sector entities; and

    (b) the cost of converting a specialised asset for an alternative use typically would be so high that the alternative use would not be considered 'financially feasible' (i.e. it would not meet the requirement in AASB 13 para. 28(c) quoted in paragraph 9 – even if that requirement was edited to reflect the NFP environment: see draft AASB 13 para. Aus28.1 discussed in Section 1).

26. In addition, one of those stakeholders (ACAG) also said:

    (a) it is not appropriate to place a heavy focus on a hypothetical market participant in the context of such specialised assets, when:

        (i) hypothetical market participants do not exist; and

        (ii) decisions about the future use and location of assets are made by Ministers rather than the management of a hypothetical market participant; and

    (b) any guidance the Board develops on the 'highest and best use' concept should focus on using existing information of the entity holding the asset rather than searching for non-existent scenarios, and provide examples that focus on realistic alternatives to determine the highest and best use.

Meaning of 'specialised asset'

27. Staff note that AASB 13 does not define a specialised asset. International Valuation Standards also do not define this term. IVS 300 *Plant and Equipment* para. 50.1 implies specialised assets are assets without direct sales evidence.

28. The 'market approach' in AASB 13 is defined as a valuation technique that uses prices and other relevant information generated by market transactions involving <u>identical or comparable (i.e. similar)</u> assets. Using those underlined words in the definition of the market approach, staff observed that the key feature of specialised assets is a general lack of market evidence of the

sales price of identical or comparable assets.

29. Staff consider it would be beneficial to include possible characteristics of specialised assets in the BC. Accordingly, staff drafted paragraphs BC26–BC27 for the Board's consideration.

Staff's observation regarding market participants and highest and best use of specialised assets

30. In response to stakeholders' comments, staff note the following related aspects:

(a) the transaction underpinning a fair value measurement is hypothetical (as noted in IFRS 13 para. BC30); therefore, market participants referred to in AASB 13 are market participants for <u>hypothetical sales transactions</u>, since the asset was not sold at the measurement date; and

(b) AASB 13 focuses on the <u>assumptions</u> that market participants would make, rather than on the identity of market participants *per se*:

  a. AASB 13 para. 22 states that: "An entity shall measure the fair value of an asset … using the <u>assumptions</u> that market participants would use when pricing the asset …, assuming that market participants act in their economic best interest."; and

  b. AASB 13 para. 23 states that: "In developing these assumptions, an entity <u>need not identify specific market participants</u>. …" [emphasis added].

31. Therefore, staff consider that a lack of observed or identified market participants does not prevent the identification of the <u>assumptions</u> that a hypothetical market participant would be likely to make when pricing a specialised asset. This is despite the fact that, because of their specialised nature, specialised assets inherently have limited (if any) market transactions involving identical or comparable assets.

Highest and best use for a specialised asset

32. Staff noted the following IASB text regarding identifying the highest and best use of an asset:

(a) AASB 13 para. 29 states a presumption that an entity's current use of an asset is its highest and best use, which is rebutted only if market or other factors suggest that a different use by market participants would maximise the value of the asset;[4] and

(b) IFRS 13 para. BC71 states 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."

Therefore, staff consider that AASB 13 is clear that the asset's current use is its highest and best use, and an entity needs only to consider readily available or readily apparent evidence of a higher and better alternative use.

33. However, stakeholders informed staff that further guidance is needed to enable the fair value of a specialised asset to be measured based on its current specialised use without incurring the cost of considering whether the 'market or other factors' referred to in AASB 13 para. 29 might exist. This is because those stakeholders do not consider the cost incurred to search for possible alternative uses of a specialised asset is justified when such assets are very unlikely to be used in any way other than their current specialised use.

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4 Staff consider that, consistent with para. Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements*, 'value of an asset' to an NFP public sector entity would include the asset's capacity to provide services to the community. This is elaborated in BC30 below.

Possible guidance on the highest and best use of specialised assets

34. Staff analysed four options to address stakeholders' concerns mentioned in paragraph 33. In all options, staff propose developing guidance regarding the perspective of market participants of specialised assets (see paragraph F1 below). The analysis of the options is summarised in the table below.

<table>
<tr><th>Option</th><th>Analysis</th></tr>
<tr><td>Option A: Developing no additional guidance on the assumed highest and best use of specialised assets, based on a view that AASB 13 para. 29 and IFRS 13 para. BC71 (quoted in paragraph 32(b) above) already provide clear guidance</td><td rowspan="2">Option A and Option B would not address the concern that NFP public sector entities might feel compelled to consider whether the 'market or other factors' (referred to in AASB 13 para. 29) might exist; and therefore, incur unnecessary cost.

Based on stakeholder feedback, staff observed that it could be argued that only in rare circumstances might a specialised asset have a higher and better alternative use. Therefore, the cost of assessing whether factors suggest a higher and better alternative use would be likely to exceed the benefits stemming from that potential assessment.</td></tr>
<tr><td>Option B: Developing public-sector-specific guidance about factors to consider when assessing a possible alternative higher and better use</td></tr>
<tr><td>Option C: Modifying AASB 13 para. 29 to specify that, for a specialised asset, the NFP public sector entity need not consider whether evidence exists that market or other factors suggest that a different use by market participants would maximise the value of the asset</td><td>The main disadvantage of Option C is that, even if AASB 13 is modified to say that a NFP public sector entity need not consider whether evidence exists of factors suggest that a higher and better alternative use, by stating an open-ended rebuttable presumption, it invites consideration of whether each specialised asset is 'the special case' in which the presumption should be rebutted.</td></tr>
<tr><td>Option D: Modifying AASB 13 para. 29 to state that, for a specialised asset, the presumption that its current specialised use is its highest and best use is rebutted when, and only when, there is evidence that, at the measurement date, the entity has committed to a plan to use the specialised asset for an alternative purpose.</td><td>Option D would overcome the cost concern noted by stakeholders. The main disadvantage of Option D is that it might be considered potentially inconsistent with IFRS 13 in that it would preclude entities from concluding that a higher and better alternative use of the specialised asset exists, if there is no evidence that the entity has committed to a plan to use the specialised asset for an alternative purpose.</td></tr>
</table>

35. In view of stakeholders' comments noted in paragraph 33 apparently indicating that they consider the guidance in AASB 13 para. 29 and BC71 (referred to in paragraph 32(b))[5] to be insufficient to avoid unnecessary searching for higher and better uses, staff consider that Options A and B should not be adopted. On balance, staff prefer Option D to Option C because only Option D would remove the risk of unnecessary searching for higher and better uses.

36. Staff's draft text of paragraphs F2 and BC23–BC33 below is based on Option D.

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5 That guidance states that IFRS 13/AASB 13 does not require an entity to perform an exhaustive search for other potential uses of an asset, and 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.

Market participants for a specialised asset

37. Para. BC78 of IFRS 13 states that: "… IFRS 13 clarifies that … an exit price reflects the sale of the asset to a market participant that has, or can obtain, the complementary assets … needed to use the specialised asset in its own operations. In effect, the <u>market participant buyer steps into the shoes of the entity that holds that specialised asset</u>." (emphasis added)

38. Applying the IASB's views in para. BC78 of IFRS 13, staff consider that, where another market participant is not readily identifiable for a specialised asset, the market participant is assumed to be another not-for-profit public sector entity 'stepping into the shoes' of the entity holding the specialised asset. An entity 'stepping into the shoes' of the holder of a specialised asset is presumed to have identical characteristics and service delivery objectives to those of the holder of the specialised asset.

39. Accordingly, staff drafted paragraphs F1 and BC34–BC37 for the Board's consideration.

Highest and best use for a specialised non-financial asset

Draft authoritative implementation guidance

F1 If a market participant is not readily identifiable for a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, the market participant is presumed to be another not-for-profit public sector entity having identical characteristics and service delivery objectives to those of the entity holding the specialised asset. That is, in the absence of better information about the characteristics of market participants and consequently the assumptions they would make when pricing such a specialised asset, the characteristics of the holder of the specialised asset and the assumptions it would make should be used in measuring the fair value of such specialised asset.

F2 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 specialised asset of a not-for-profit public sector entity held primarily for its service capacity, its current specialised use is presumed to be its highest and best use, unless there is evidence that, at the measurement date, the entity has committed to a plan to use the specialised asset for an alternative purpose.

Draft Basis for Conclusions

Stakeholders' requests regarding fair value measurement of specialised assets

BC23 The Board noted that:

(a) 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; and

(b) IFRS 13 para. BC71 states 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."

However, notwithstanding these paragraphs, stakeholders requested the Board to provide guidance in identifying the highest and best use of a specialised asset of a not-for-profit public sector entity held primarily to provide a specific public service. These stakeholders do not consider the cost incurred to search for possible alternative uses of a specialised asset is justified when such an asset is very unlikely to be used in any other way other than its current specialised use.

BC24 In addition, stakeholders requested the Board provide guidance on:

(a) the perspectives of market participants about various specialised assets (see paragraphs BC34–BC37); and

(b) the implications of those perspectives for identifying the interest rates to apply in estimating the current replacement cost of specialised assets, if borrowing costs are included in an asset's current replacement cost (see paragraphs BC44–BC47).

BC25 The Board considered stakeholders' feedback and added paragraphs F1–F2.

Meaning of a specialised asset

BC26 This Standard does not define 'specialised asset'. The Board noted that this term is also not defined in International Valuation Standards (IVS). IVS 300 *Plant and Equipment* para. 50.1 implies specialised assets are assets without direct sales evidence.

BC27 The Board considered that a specialised asset typically has components modified to such an extent that observable market inputs of identical or comparable assets do not exist in an active market. It may also be a partially consumed asset for which only new asset prices are observable in an active market.

The highest and best use of a specialised asset

BC28 Under paragraph 28(c), the highest and best use of a non-financial asset takes into account the use of the asset that is financially feasible (also see paragraph Aus28.1 and BC19–BC22). The Board considered that, in respect of a specialised asset of a not-for-profit public sector entity held primarily to provide a specific public service, its highest and best use is presumed to be its current specialised use. This is because:

(a) consistent with the IASB's conclusion noted in IFRS 13 para. BC71, the cost of converting a specialised asset to use it for another purpose would often be very high (e.g. converting a hospital building into a residential building). That is, an alternative use would be unlikely to be financially feasible, in terms of the 'financially feasible' aspect of a non-financial asset's highest and best use in paragraph 28;

(b) generally, the services that a specialised asset provides are necessary services provided by a government to its community. Therefore, it is unlikely that a government or other public sector entity would use a specialised asset for a purpose other than its current specialised use; and

(c) in some cases, the services that a specialised asset provide are unique (e.g. defence weapons platforms), and there would not be another Government or another not-for-profit public sector entity (i.e. there would not be another market participant) that would acquire the asset to provide different services with it.

BC29 The current use presumption of a specialised asset is rebutted only if there is evidence that, at the measurement date, the entity has committed to a plan to use the specialised asset for an alternative use. The Board considered that if an entity has committed to a plan to use an asset for an alternative use, the entity would have considered the alternative use is financially feasible, as well as physically possible and legally permissible. In this case, the highest and best use of that asset would be the planned alternative use. This is because an entity would only commit to a plan to use an asset for an alternative use if that use would maximise the value of the asset.

BC30 The Board considered that the value of a specialised asset of a not-for-profit public sector entity is not limited to the amount of net cash inflows it could generate directly, but:

(a) the net cash inflows that the asset could generate should be regarded as including indirect financial support (in the form of rates, taxes, grants and appropriations) – however, it is inherently difficult to attribute or allocate indirect financial support to the unit of account for fair value measurement, namely, each asset; and

(b) that value can be assessed in terms of the amount a market participant would be prepared to pay to acquire the asset to provide needed services to beneficiaries (and this amount usually can be identified more readily than the amount referred to in (a) for each asset).

BC31 The rationale in paragraph BC28(c) is not limited to specialised assets; however, non-specialised assets typically have observable market inputs of identical or comparable assets, under which the sale price for hypothetical sale of the asset can be estimated reliably.

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

BC32 Under AASB 5 paras. 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.

BC33 For the purposes of paragraph F2, the presumption that the current use of a specialised asset is its highest and best use can be rebutted even if the conditions in AASB 5 are not met. For the presumption to be rebutted, the entity need not have initiated, at the measurement date, an active programme to locate a buyer or complete the plan to use the specialised asset for an alternative purpose. In addition, in contrast with AASB 5, under paragraph F2, it is not essential that the committed-to plan is for the sale of the specialised asset: the plan may be to use the specialised asset for an alternative purpose.

Characteristics of market participants of a specialised asset

BC34 As noted in paragraph BC28(c), some stakeholders expressed the view that, in some cases, the services that a specialised asset provide are unique, and there would not be another Government or another not-for-profit public sector entity that would provide such services. Therefore, they argued, there would not be another market participant for most specialised assets held by not-for-profit public sector entities. The Board concurs with this view; and therefore added paragraph F1.

BC35 Applying the IASB's views IFRS 13 para. BC78, the Board considered that, where another market participant is not readily identifiable for a specialised asset, the market participant is assumed to be another not-for-profit public sector entity 'stepping into the shoes' of the entity holding the specialised asset. An entity 'stepping into the shoes' of the holder of a specialised asset is presumed to have identical characteristics and service delivery objectives to those of the holder of the specialised asset.

BC36 The Board noted comments from stakeholders that for some specialised assets, another not-for-profit public sector entity with similar service delivery objectives does not exist. However, the Board considered:

(a) the sale transaction that is the subject of a fair value measurement is a hypothetical transaction rather than an actual transaction (per IFRS 13 para. BC30); therefore, it is appropriate to assume that the rationale in IFRS 13 paras. BC78–BC79 (that, "in effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset") supports assuming a hypothetical market participant buyer that has identical characteristics and service delivery objectives to those of the entity holding the specialised asset; and

(b) because the sale transaction that is the subject of a fair value measurement is a hypothetical transaction, AASB 13 does not assume the fanciful notion of an entity selling an asset to itself.

BC37 Furthermore, the Board noted the statement in AASB 13 para. 22 that "In developing these assumptions, an entity need not identify specific market participants. …" indicates the primary focus is on the assumptions that market participants would use when pricing an asset, and not the identity of market participants. The Board considered that it should not be important to fair value measurements whether another public sector entity with similar service delivery objectives actually exists: if one does not, the market participant should be assumed to have similar needs for the asset to those of the not-for-profit public sector entity holding the specialised asset. That is, in the absence of better information about the characteristics of market participants and consequently the assumptions they would make when pricing an asset, the characteristics of the holder of the asset and the assumptions it would make should be used.

Questions for Board members

Q6: Do Board members agree to include authoritative implementation guidance in AASB 13, so that, for a specialised asset of an NFP public sector entity held primarily for its service capacity:

(a) if a market participant is not readily identifiable, the market participant is presumed to be another NFP public sector entity having identical characteristics and service delivery objectives to those of the entity holding the specialised asset (draft AASB 13 para. F1); and

(b) its current specialised use is presumed to be its highest and best use, unless there is evidence that, at the measurement date, the entity has committed to a plan to use the specialised asset for an alternative purpose (draft AASB 13 para. F2)?

Q7: If Board members disagree with the staff recommendations in Q6, which alternative(s) do Board members propose to address stakeholders' concern that the cost incurred to search for possible alternative uses of a specialised asset is not justified when such assets are very unlikely to be used in any way other than their current specialised use?

Q8: Do Board members agree with the content of draft paragraphs BC23–BC37?

Section 3: Borrowing costs under the cost approach

40. AASB 13 does not specify whether borrowing costs are required to be included in a self-constructed asset's current replacement cost (CRC) when measuring its fair value under the cost approach.

41. At its June 2019 meeting, the Board tentatively decided the issue of whether to include borrowing costs under the cost approach affects for-profit and NFP entities alike. In light of the IASB not specifying the treatment of borrowing costs for fair value measurements by for-profit entities, the Board reached the tentative view that it would be inappropriate to mandate a particular treatment for NFP entities applying AASB 13.

42. The Board also reached a tentative view that an entity's accounting policy choice for borrowing costs at initial recognition under AASB 123 *Borrowing Costs* is irrelevant to how those costs should be treated when measuring the fair value of an asset at subsequent measurement.

43. ITC 45 respondents expressed mixed views regarding whether borrowing costs should be included in the CRC of a self-constructed asset.

Guidance requested

44. Some NFP public sector stakeholders consider this issue is pervasive in the NFP public sector because many self-constructed assets are measured at fair value under the cost approach. They requested the Board to provide guidance to:

    (a) clarify whether borrowing costs should be included in the CRC of an asset;

    (b) identify who the market participant buyers are for an asset (to determine the borrowing rate to apply), particularly for specialised assets financed by private sector entities, because interest rates in the public sector generally are significantly lower than in the private sector.

45. Staff noted stakeholders' request and consider it desirable for the Board to provide guidance on the issue in paragraph 44(b) regarding borrowing costs associated with a self-constructed asset that is considered specialised. The identification of the entity for which the borrowing rate is selected should be based on market participant assumptions.

46. Consistent with the discussion of market participants for a specialised asset in Section 2, staff propose that, if an entity determines that borrowing costs should be included in the CRC of a specialised asset held by a NFP public sector entity primarily for its service capacity:

    (a) if a market participant is readily identifiable, the market participant's borrowing rate is used; and

    (b) If a market participant is not readily identifiable, the borrowing rate used is:

        (i) that NFP entity's borrowing rate for such an asset; or

        (ii) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs.

47. Staff prepared the following draft implementation guidance and BC paragraphs for the Board's consideration.

Borrowing costs

Draft authoritative implementation guidance

F3 When measuring the current replacement cost of a self-constructed asset of a not-for-profit public sector entity held primarily for its service capacity, the entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset.

F4 If a not-for-profit public sector entity includes borrowing costs in the fair value of a self-constructed asset measured at current replacement cost, the borrowing rate used to measure those borrowing costs is, subject to paragraph F5, the borrowing rate of market participants incurred to finance the acquisition of the same asset or a similar asset.

F5 If the asset referred to in paragraph F4 is a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, and a market participant is not readily identifiable, the borrowing rate used is:

(a) the borrowing rate for the asset of the entity holding the asset; or

(b) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs.

Draft Basis for Conclusions

General issue

BC38 The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include borrowing costs in the fair value of a self-constructed asset measured at current replacement cost under the cost approach (e.g. whether the current replacement cost of a self-constructed freeway should include borrowing costs incurred during construction). This issue relates to all self-constructed assets of such entities measured at current replacement cost.

BC39 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of a self-constructed 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.

BC40 The Board considers that a not-for-profit public sector entity, in deciding whether it should include borrowing costs in the current replacement cost of a self-constructed asset, should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset.

BC41 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 a self-constructed asset if that entity elects, under paragraph Aus8.1 of AASB 123 *Borrowing Costs*, not to capitalise borrowing costs into the cost of qualifying assets. The Board considers 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 the asset that necessarily takes a substantial period of time to get ready for its intended use.

BC42 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.

BC43 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. International Valuation Standard IVS 105 *Valuation Approaches and Methods* includes:

> "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: … <u>7. finance costs (eg, interest on debt financing)</u>, and 8. profit margin/entrepreneurial profit to the creator of the asset (eg, return to investors)." (paragraph 70.11, emphasis added)

Which entity's borrowing rate should be used?

BC44 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 are to be included in the asset's current replacement cost. The Board considered that the decision about which entity's borrowing rate should be used depends on the identification of the characteristics of the market participant making that pricing decision.

BC45 Applying the principle in AASB 13 paragraph B9 that "a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset", the amount of any cost (finance or other) that should be included in an asset's current replacement cost is the amount of borrowing costs that market participants save by acquiring the asset from the entity. Therefore, the borrowing rate of market participants should be used.

BC46 As mentioned in paragraph F1, if a market participant is not readily identifiable, the market participant buyer for a specialised asset of a not-for-profit public sector entity held primarily for its service capacity is assumed to be another not-for-profit public sector entity with identical or similar purposes for holding the asset, 'stepping into the shoes' of the entity holding the asset. Therefore, for such assets, the market participant is assumed to incur the same borrowing rate as the not-for-profit public sector entity holding the asset for financing the construction of that particular asset, if different from that entity's general borrowing rate (disregarding any discount provided by the Government below the government bond rate if it borrows from the Government).

BC47 However, in the case of a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, one further issue remains. That issue is: if the borrowing costs incurred by the Government that controls that entity are not passed on to that entity, should the borrowing rate be assumed to be zero in measuring the current replacement cost of the specialised asset? Answering this question involves identifying the costs that another not-for-profit public sector entity 'stepping into the shoes' of the entity holding the asset would be prepared to pay for when pricing the asset – these may be regarded as the costs avoided by that market participant by acquiring the asset. The Board concluded that the treatment should be consistent with that of any donated resources, whether labour, materials or finance, when applying the cost approach. Therefore, the Board concluded that, if borrowing costs are included in the current replacement cost of a specialised asset of a not-for-profit public sector entity held primarily for its service capacity, the borrowing rate that should be used is:

(a) the borrowing rate for the asset of the entity holding the asset; or

(b) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs.

BC48 This Standard does not address the issue of whether other finance costs than borrowing costs (such as an imputed cost of equity on a typical equity proportion of financing the construction of an asset) should be included in estimates of an asset's current replacement cost.

Questions for Board members

Q9: Do Board members agree that, as proposed in paragraph F3, when measuring the current replacement cost of a self-constructed asset of an NFP public sector entity held primarily for its service capacity, the entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset?

Q10: Do Board members agree that, as proposed in paragraph F4, if an NFP public sector entity includes borrowing costs in the fair value of a self-constructed asset measured at current replacement cost, the borrowing rate used to measure those borrowing costs is the asset-specific borrowing rate of market participants?

Q11: Do Board members agree that, as proposed in paragraph F5, if the asset referred to in paragraph F4 is a specialised asset, and a market participant is not readily identifiable, the borrowing rate used is:

(a) the borrowing rate for the asset of the entity holding the asset; or

(b) where no such rate exists (i.e. that entity does not have borrowings) the borrowing rate for such an asset of the Government to which the entity belongs?

Q12: If Board members disagree with any of paragraphs F3–F5 referred to in Q9–Q11, which alternative proposals do Board members recommend?

Q13: Do Board members agree with the content of draft paragraphs BC38–BC48?

Section 4: Nature of component costs (other than borrowing costs) to include in an asset's CRC

Requirements in AASB 13

48. AASB 13 paras. B8–B9 state [emphasis added]:

> B8 The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
>
> B9 From the perspective of a 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 substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset …

Guidance requested and the Board's tentative decisions

49. AASB 13 does not specify the nature of the component costs to include when calculating an asset's current replacement cost (CRC), under the cost approach. Stakeholders have requested the Board to consider providing guidance to clarify the types of costs to include when considering the cost of a 'modern equivalent asset' (i.e. an asset that provides similar function and equivalent utility to the asset being valued, but which is of a current design and constructed using current cost-effective materials and techniques), in order to calculate an asset's CRC under the cost approach in AASB 13.

50. When considering the amount that would be required currently to replace the service capacity of an asset, an entity considers the least costly manner to acquire or construct a modern equivalent asset if such an asset is available and not more expensive per unit of service potential than a reproduction of the asset. The 'least costly manner' principle reflects the assumption in AASB 13 para. 22 that market participants act in their economic best interest.

51. The following Table summarises the guidance stakeholders have requested in 2019 and the Board's tentative decisions made to date in respect of them.

<table>
<tr><th>Guidance requested</th><th>The Board's tentative decisions</th></tr>
<tr><td>(a) Whether once-only costs (e.g. formation costs for constructing a road) should be included in an asset's CRC</td><td rowspan="2">All necessary costs intrinsically linked to acquiring or constructing a modern equivalent asset at the measurement date should be included, including:
• once-only costs; and
• any make-good costs that must be incurred for surrounding assets of another entity disturbed when the entity's asset is replaced.</td></tr>
<tr><td>(b) If costs would need to be incurred to make good surrounding assets of another entity upon replacing the entity's asset (e.g. making good drainage works of another entity disturbed upon replacing the entity's road), whether those make-good costs should be included in the asset's CRC.</td></tr>
<tr><td>(c) Whether the 'least costly manner' concept would include higher costs than those theoretically achievable where a more costly mode of replacement is necessary to meet community expectations.</td><td>The 'least costly manner' principle should be applied in the context of the entity's mode of replacement in the ordinary course of operations, which would take into account community expectations, operational mandates or other imperatives to incur costs additional to the theoretically cheapest legally permitted costs to maintain an adequate quality of services.</td></tr>
</table>

52. The feedback received in the FVM project in 2019-21 indicated that a majority of stakeholders agree that Accounting Standards should set out the principles of replacement cost, and that all necessary costs intrinsically linked to acquiring or replacing an asset should be included.

Comments received on ITC 45

53. APV and API agree with the Board's view that all necessary costs intrinsically linked to acquiring or replacing an asset at the measurement date should be included.

54. HoTARAC and ACAG did not indicate explicitly whether they agree with the Board's tentative view. However, they commented that more guidance is needed on the concept of the cost of a modern equivalent asset. In particular, ACAG mentioned that it would be useful to provide guidance on the issues noted in paragraph 51. These issues are addressed in the following draft implementation guidance and BC paragraphs.

Nature of costs included in current replacement cost

Draft authoritative implementation guidance

F6 When applying the cost approach under paragraphs B8–B9 to measure the fair value of a non-financial asset held primarily for its service capacity, a not-for-profit public sector entity assumes 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. Therefore, all necessary costs intrinsically linked to acquiring or constructing a modern equivalent asset at the measurement date shall be included in such an asset's current replacement cost. These costs include, but are not limited to:

(a) once-only costs;

(b) costs of removal and disposal of existing structures; and

(c) any make-good costs that must be incurred for surrounding assets of another entity disturbed when the entity's asset is replaced.

F7 For example, the following once-only costs associated with a road are included in its current replacement cost: design work, earthworks, road formation and cost to acquire the land under the road.

F8 In respect of paragraph F6(b), an asset's current replacement cost would also include costs necessarily incurred to remove and dispose of existing structures (e.g. buildings incompatible with the entity's operational needs) in order to construct the asset being measured.

F9 The cost approach assumes a hypothetical replacement of an asset in the most economical operationally feasible manner. A not-for-profit public sector entity includes in an asset's current replacement cost all necessary costs required to be incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity. This is because, to maintain an adequate quality of services, a not-for-profit public sector entity takes into account community expectations, operational mandates or other imperatives when planning a replacement of an asset, and these considerations could lead to incurring additional costs.

F10 For example, where a replacement of the surface of a road would, in the ordinary course of operations, occur at night rather than during daytime to minimise disruption to drivers, the more costly night costs should be included in the asset's current replacement cost rather than the lower daytime costs. This is because it would be infeasible to avoid paying the higher night cost, since replacement of the surface of the road in the daytime would be incompatible with community expectations regarding continuity of service.

Draft Basis for Conclusions

BC49 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 paragraphs B8–B9, particularly where such an asset is constructed by or on behalf of the entity (i.e. not replaced in a single transaction).

BC50 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 (i.e. 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 land, 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 (i.e. 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).

BC51 The Board concluded that neither View 1 nor View 2 fully reflect the principles of AASB 13. This is because:

(a) IFRS 13 para. 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) 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 substitute asset of comparable utility, adjusted for obsolescence.

BC52 The Board concluded that the current replacement cost of assets includes all necessary costs intrinsically linked to acquiring the asset at the measurement date. This is because a market participant buyer of the entity's asset would need to incur those costs if it acquires the asset at the measurement date, whether that buyer acquires the asset from the entity or constructs the asset itself. Consequently, in estimating the current replacement cost of an asset, it should be assumed that the asset presently does not exist (i.e. the market participant buyer does not presently possess the asset and needs to acquire it in its entirety); and therefore the following costs should be included in an asset's current replacement cost:

(a) once-only costs should be included; and

(b) costs of removal and disposal of existing structures.

BC53 The Board reached the view that the current replacement cost of an asset includes necessary once-only costs that market participants would expect to incur when constructing the asset, despite those components not being expected to be replaced by the entity holding the asset. Current replacement cost assumes hypothetical replacement 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.

BC54 Entities would need to apply judgement in the circumstances of the asset being measured to determine the necessary costs intrinsically linked to acquiring or constructing a modern equivalent asset at the measurement date, assuming the asset presently does not exist (in accordance with paragraph F6). As indicated in paragraph F8, an entity applies judgement to determine whether it would be necessary for the market participant to remove and dispose of existing structures in order to construct the asset being measured.

BC55 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 that building on a vacant site. If suitable vacant sites are available (e.g. an adjacent vacant site), 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').

Make-good costs

BC56 Holders of View 2 argue that it would be inappropriate to include the make-good costs for surrounding assets controlled by another entity disturbed when the entity's asset is replaced (e.g. drainage works disturbed when replacing a road) if the entity did not incur those costs when the asset subject to measurement was initially constructed, or if those surrounding assets did not exist when the asset being measured was initially constructed. They are of the view that:

(a) make-good costs for disturbing surrounding assets that did not exist when the asset was initially constructed do not enhance the service capacity of the asset. To them, current replacement cost simply remeasures the costs included in an asset's historical cost, adjusted for obsolescence; and

(b) if make-good costs were included in the current replacement cost of an asset without having been incurred during the asset's initial construction, the asset's fair value would increase simply because of a change in the asset's operating environment (i.e. without the entity having improved the asset's service capacity). They argued that recognition of such an increase in the asset's fair value would not faithfully represent the entity's performance, especially since the entity has yet to incur any costs on making good the surrounding assets of another entity).

BC57 The Board considered the comments in paragraph BC56 and concluded that:

(a) 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 capacity to produce outputs not having improved. This is because all costs to make good another entity's asset would necessarily be incurred by a market participant if it were to acquire or construct the asset at the measurement date. Those additional make-good costs are necessarily incurred to obtain access to the net cash inflows, or services, that the asset is expected to generate. Similarly, a market participant would consider the costs currently avoided by possessing the asset: these costs are not limited to those already incurred by the entity; and

(b) any costs that hypothetically would be incurred to make good other assets of the entity disturbed when the asset subject to measurement is replaced are excluded from the current replacement cost calculation. Including any make-good costs of the entity's own assets in those current replacement costs would double-count those costs. This is because, 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. That is, the sum of the current replacement costs of each of the entity's assets should exclude any make-good costs relating to the entity's own assets.

Questions for Board members

Q14: Do Board members agree that, as proposed in paragraphs F6–F8, when applying the cost approach to measure the fair value of an asset held primarily for its service capacity, all necessary costs intrinsically linked to acquiring or constructing a modern equivalent asset at the measurement date should be included in such an asset's current replacement cost, and that these costs should include:

(a) once-only costs;

(b) costs of removal and disposal of existing structures; and

(c) any make-good costs that must be incurred for surrounding assets of another entity disturbed when the entity's asset is replaced?

Q15: Do Board members agree that, as proposed in paragraph F9, a not-for-profit public sector entity should include in an asset's current replacement cost all necessary costs required to be incurred in the context of the entity's mode of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity?

Q16: Do Board members agree with the draft text in paragraphs BC49–BC57?

Section 5: Assumed location of an asset measured under the cost approach

Guidance requested

55. AASB 13 does not specify whether fair value measurements under the cost approach should assume continued use of the asset in its existing location, particularly if an alternative site involves a cheaper location. Since the cost approach assumes an asset would be replaced in the most economical manner, NFP public sector stakeholders requested guidance to identify the assumed location of an asset when measuring the fair value of an asset under the cost approach.

56. At its June 2019 meeting, the Board reached a preliminary view that, theoretically, under some circumstances, an asset's CRC would be measured assuming its replacement in a cheaper alternative location. The rationale for that view is noted in paragraph BC64 below.

57. However, after further deliberation, at its November 2019 meeting, the Board reached a different conclusion that it should be assumed that the asset is being replaced at its existing location under the cost approach. All five respondents on ITC 45 who commented on this topic agreed with the Board's tentative decision. Staff drafted the following implementation guidance and BC paragraphs based on this view.

Assumed location of real property when applying the cost approach

Draft authoritative implementation guidance

F11 When measuring an item of real property of a not-for-profit public sector entity held primarily for its service capacity using the cost approach under paragraphs B8–B9, the entity assumes the real property will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper site.

Draft Basis for Conclusions

BC58 The issue relates to real property of a not-for-profit public sector entity held primarily for its service capacity and measured under the cost approach (e.g. a public school or public hospital).

BC59 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 paragraph B9) reflects the price of the property in the cheaper location.

BC60 Some stakeholders argued that the property's market 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 property in a cheaper location.

BC61 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):[6]

> "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)

BC62 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.

6 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).

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)

BC63 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.

BC64 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 include the market price of land 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 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.

BC65 However, on further deliberation, the Board observed that the approach described in paragraph BC64 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 present location because the service capacity of a property being replaced is the sum of:

   (i) its capacity to provide services in its existing 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.

BC66 In light of the concerns in paragraph BC65, the Board concluded that the current replacement cost of an item of real property of a not-for-profit public sector entity held primarily for its service capacity would be measured by assuming it is replaced in its existing location, even if it would be feasible to relocate the facility to a cheaper site.

Questions for Board members

Q17: Do Board members agree that, as proposed in paragraph F11, when measuring an item of real property of a not-for-profit public sector entity held primarily for its service capacity using the cost approach, the entity should assume the real property will be replaced in its existing location, even if it would be feasible to replace the property in a cheaper site?

Q18: Do Board members agree with the draft text in paragraphs BC58–BC66?

Section 6: Economic obsolescence under the cost approach

58. At its April 2019 meeting, the Board made a tentative decision to illustrate in the FVM ED the application of AASB 13's requirements regarding consideration of economic obsolescence when measuring an asset's current replacement cost. The Board decided that economic obsolescence should not:

(a) be identified if the asset has apparent 'excess capacity' that is temporary or occurs cyclically; and

(b) be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity.

59. Four respondents commented on this topic in ITC 45, and all of them agree with the Board's tentative decision. Staff drafted the following implementation guidance and BC paragraphs based on the Board's tentative decision.

Economic obsolescence (paragraph B9)

Draft authoritative implementation guidance

F12 When a non-financial asset held by a not-for-profit public sector entity held primarily for its service capacity is measured under the cost approach under paragraph B8 has suffered a reduction in demand for its services, the identification of 'external (i.e. 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.

F13 When an asset described in paragraph F12 has apparent overcapacity in view of current demand for its services, economic obsolescence shall not be identified for that asset if there is more than an insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future.

F14 An example of where economic obsolescence of an asset would be identified when applying the criterion in paragraph F13 is a public school 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 for any temporary or underestimated student demand (i.e. there is only an insignificant chance that this reduction in needed capacity will reverse within the foreseeable future). In this example, the school improvements' 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's buildings and other facilities (e.g. physical obsolescence) would be deducted. Consistent with paragraph F12, this would be the case regardless of whether a formal decision has been made to reduce the school's capacity.

Draft Basis for Conclusions

BC67 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".

BC68 An equivalent notion of economic obsolescence of an asset or facility held by a not-for-profit 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 when to 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.

BC69 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 current 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.

BC70 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 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 paragraph 22 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset.

BC71 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).

BC72 The Board noted that part of the debate about when 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 economic obsolescence should not be identified for a facility with a current apparent overcapacity if there is more than an insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future. Such an illusory overcapacity might be created to cater for expected increases in future demand for the facility's services.

BC73 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[7] 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."

BC74 The Board was asked to provide guidance on whether, for assets measured at current replacement cost and affected by economic obsolescence (e.g. 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 (e.g. based on a school for 100 students in the example in paragraph F14), would be required at the measurement date.

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

Questions for Board members

Q19: Do Board members agree that:

(a) as proposed in paragraph F12, when a non-financial asset held by a not-for-profit public sector entity and measured under the cost approach under paragraph B8 has suffered a reduction in demand for its services, the identification of 'external (i.e. economic) obsolescence' should not require a formal decision to have been made to reduce the physical capacity of that asset? and

(b) as proposed in paragraph F13, when an asset described in paragraph F12 has apparent overcapacity in view of current demand for its services, economic obsolescence should not be identified for that asset if there is more than an insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future?

Q20: Do Board members agree with the example in paragraph F14?

Q21: Do Board members agree with the draft text in paragraphs BC67–BC74?

Section 7: Approaches to estimating the fair value of certain assets

Guidance requested – Valuation techniques

60. A Panel member requested the Board to consider issuing guidance on which types of assets should be valued under the market, income or cost approach (the three 'valuation techniques' mentioned in AASB 13 para. 61), particularly for various types of specialised assets. Those types of assets are described in paragraph BC76.

61. In its comments to the IPSASB on IPSASB ED 77 *Measurement*, the Board expressed a view that the selection of the measurement technique to measure the fair value of restricted assets should be in accordance with the general principles in AASB 13. Staff consider that, applying the same logic, the selection of appropriate measurement technique for particular types of assets should not be constrained further than as specified by the general principles in AASB 13. Doing so would be inconsistent with the requirement of AASB 13 para. 61 for 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.

62. Therefore, staff consider it would be inappropriate to provide the specific guidance requested on the types of assets described in paragraph BC76. Staff have noted this in draft paragraphs BC77–BC80.

Guidance requested – Effects of restrictions

63. In its comment letter on ITC 45, ACAG requested the Board to provide guidance on how restrictions should be applied in fair value measurement to help reduce the divergent practices between public sector financial statements preparers and valuers regarding whether a discount should be applied to fair value measurements of restricted assets and, if so, the quantum of that discount. In light of the Board's decision noted in paragraph 61, albeit made in the context of its submission on IPSASB ED 77, staff consider that it would be inappropriate for Accounting Standards to specify whether a discount is applied in measuring the fair value of assets with restrictions.

64. Staff also consider that it would be inappropriate for Accounting Standards to specify the quantum of any discount used in measuring the fair value of assets with restrictions. Since the conditions and location of every parcel of land are likely to differ, and the effect of restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted (where that likelihood is more than remote) and whether the land is urban, suburban or rural, it would neither be practical nor appropriate for Accounting Standards to specify the amount of appropriate adjustments (e.g. in percentage terms) to reflect the effect of restrictions that would transfer to market participants.

Restricted land and specialised improvements on restricted land

65. Early in the FVM project, stakeholders asked the Board to specify the appropriate measurement technique to apply in measuring the fair value of restricted assets, in particular restricted land and specialised improvements on restricted land. In 2019–20 the Board had tentatively decided to propose guidance that the cost approach should be used to measure the fair value of restricted assets of an NFP public sector entity held primarily for their service capacity.

66. However, as part of its deliberation of IPSASB ED 77, in addition to its views noted in paragraph 61, the Board expressed a view that, unless there is significant diversity in applying accounting principles in practice regarding fair value measurement of restricted assets (e.g. restricted land), there is no clear case for mandating the use of a particular measurement technique in measuring the fair value of a particular asset or asset class.

67. In accordance with paragraph 7.3.6 of the Due Process Framework, staff consider it appropriate to document the Board's decision to retain the status quo in the BC section of the FVM ED. Staff have drafted the following BC paragraphs based on that revised Board view.

Approaches to estimating the fair value of specific assets

Draft Basis for Conclusions

Stakeholders' requests

BC75 The Board has been requested to consider issuing guidance:

(a) on which types of 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 restricted assets, on the quantum of that discount.

BC76 In relation to the request noted in paragraph BC75(a), the asset types on which stakeholders have requested guidance include:

(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 the 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).

The Board's deliberations

BC77 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.

BC78 AASB 13 para. 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.

BC79 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 Accounting Standards should not limit the application of the market approach, income approach or cost approach beyond the requirements in AASB 13 para. 61.

BC80 The stakeholders' suggestion to issue guidance specifying the approach to apply to a type of asset would conflict with the requirements of AASB 13 para. 61 because it might constrain entities from using the best evidence of fair value in the circumstances. In addition, AASB 13 paras. 62–63 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.

BC81 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 BC75(b)), the Board noted that the market approach for non-financial assets is primarily applied by not-for-profit public sector entities to their holdings of land. The Board rejected the notion of developing guidance on the quantum of discounts in relation to land for the reasons set out in paragraph BC103.

Stakeholders' request regarding restricted land and improvements on restricted land

BC82 Many land holdings and improvements on land of not-for-profit public sector entities are held primarily for their service capacity, and some of those assets have legal restrictions imposed on their use or the prices that can be charged for using them. Stakeholders asked the Board to provide guidance to help not-for-profit public sector entities determine which of the three measurement techniques (the market, income and cost approach) is the appropriate technique for measuring the fair value of such restricted assets.

BC83 Stakeholders have informed the Board that the fair value of some restricted land held by not-for-profit public sector entities primarily for the service capacity has been valued at a very low amount; sometimes a nominal amount (e.g. $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 para. Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements* (applicable to not-for-profit entities), which states that, in respect of not-for-profit entities, 'future economic benefits' or 'service potential' can be described as 'the scarce capacity to provide benefits to the entity that use them'.

BC84 The Board did not form a view on whether measuring such restricted land mentioned in paragraph BC83 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* (Revised Conceptual Framework) for application by not-for-profit entities, including public sector entities. 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.

Land: Restrictions specific to an asset versus restrictions specific to an entity

BC85 The Board noted all land holdings are subject to some form of legal restriction because land is zoned for a particular purpose.

BC86 As mentioned in paragraph BC3, the Board noted that the fair value measurement of land would:

(c) not take into account a restriction that is specific to the entity holding the asset, i.e. would not transfer to market participants in a hypothetical sale transaction (e.g. the restriction on use of land that is specific to the entity, in the IASB's example in paragraph IE29 of the Illustrative Examples accompanying IFRS 13); but

(d) take into account the effect of restrictions that would transfer to market participants in a hypothetical sale transaction (e.g. the easement restrictions in the IASB's example) regardless of whether in that example the highest and best use is as a playground or as a site for residential development, because such legal restrictions are considered characteristics of land that a market participant would consider when pricing the land.

Improvements on restricted land

BC87 The Board noted that, in some cases, legal restrictions imposed on a not-for-profit public sector entity limiting the use of an improvement (e.g. a building) on a parcel of restricted land, or the prices that can be charged for using that improvement, are entity-specific restrictions that would not be transferred to market participants. In this case, the fair value measurement of those improvements would not take into account that pricing restriction that would not transfer to market participants.

Feedback from public sector stakeholders

BC88 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 held primarily for their service capacity are being measured. In this regard:

(a) most stakeholders commented that the market approach is used to measure the fair value of land, including restricted land; whereas improvements on restricted land are generally considered specialised assets, for which the cost approach is 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 held primarily for its service capacity is subject to public-sector-specific restrictions, but an equivalent restricted parcel of land 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.

BC89 The views of these stakeholder groups are elaborated on in paragraphs BC90–BC98.

The minority view regarding restricted land

BC90 The minority of stakeholders mentioned in paragraph BC88(b) considered that the cost approach would be the most appropriate measurement technique for measuring the fair value of restricted land where an equivalent restricted parcel of land 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, the fair value of restricted land would not be lower than the price of equivalent unrestricted land because of the effect of the 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 unrestricted parcel of land to continue delivering services, and the existence of a restriction does not affect the price of this purchase.

BC91 'Equivalent unrestricted land' referred to in paragraph BC90 might be restricted in use by zoning other than for a public-sector-specific purpose (e.g. it might be zoned for residential, commercial or light industrial use) or by an easement providing access to other services.

BC92 Those stakeholders reached this view because they interpreted that, when applying the IASB's views in IFRS 13 paras. BC78–BC79:

(a) many parcels of specialised land might have little value if sold (due to the restrictions), but would have a significant value when used together with other non-financial assets; and

(b) the cost or income approach might be more appropriate 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.

BC93 Further, those stakeholders considered that, because the restricted land is held primarily for its service capacity and not primarily 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 restricted land

BC94 The majority of stakeholders mentioned in paragraph BC88(a) expressed the view that land, including restricted land, should generally be measured using the market approach. They disagree with the view expressed by the minority of stakeholders noted in BC90 – that the cost approach should be applied in measuring restricted land, and the fair value of restricted land would not be lower than the price of equivalent unrestricted land because of the effect of the 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 that would transfer to market participants in a hypothetical sale transaction.

BC95 This majority of stakeholders commented that although an 'equivalent' parcel of land with the same public-sector-specific restrictions might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence, 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.

BC96 These stakeholders also commented that, if a parcel of land has improvements on it (e.g. a hospital building), the improvements reduce the service potential of the land. They are of the view 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.

BC97 Some stakeholders commented that there is diversity in practice on the amounts (e.g. percentages) of adjustments being deducted from the market price of nearby unrestricted land, and asked the Board to consider providing guidance to reduce diversity.

BC98 Further, some stakeholders informed the Board that different valuers use different methods in calculating the adjustments to be deducted from the market price of nearby unrestricted land that is, or may be, used as a reference asset, for example:

(a) using the price of nearby unrestricted land 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 unrestricted land 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).

The Board's decision to not provide authoritative implementation guidance

BC99 Notwithstanding the interpretation of IFRS 13 paras. BC78–BC79 by a minority of stakeholders, in which they conclude that the cost approach would often be appropriate in measuring the fair value of restricted land, 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.

BC100 Therefore, the Board considers that determining appropriate measurement techniques for measuring the fair value of an asset is best regarded as belonging within the province of valuation professionals 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 asset or asset class.

BC101 Despite the debate regarding fair value measurement of restricted land, feedback from most stakeholders in targeted outreach and feedback on ITC 45 indicated that, in practice, the fair value of each class of assets is being measured using a largely consistent approach – that is:

(a) for restricted land, the market approach is used (although, as noted in paragraph BC98, different methods are being used to calculate the adjustments to reflect restrictions); and

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

BC102 In regard to the stakeholders' comment in paragraph BC97, 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.

BC103 Since the conditions and location of every parcel of land are likely to differ, and the effect of restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted (where that likelihood is more than remote) 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 (e.g. in percentage terms) to reflect the effect of restrictions that would transfer to market participants.

Question for Board members

Q22: Do Board members agree with draft paragraphs BC75–BC103?

Section 8: Confirming the scope of the FVM ED

68. As mentioned in paragraph 4 and in the Appendix, the draft guidance included in this paper has a slightly different scope to the scope of the working draft FVM ED considered by the Board in 2019–20. The changes in scope that staff are recommending are that the FVM ED should:

(a) propose modifications to AASB 13 and guidance regarding market participants and the highest and best use of specialised assets (as discussed in Section 2); but

(b) not provide guidance specifically on how to measure restricted assets (including restricted land and restricted concessionary ROU assets) as discussed in the draft BC paragraphs in Section 7, or to provide guidance specifically on the treatment of restrictions affecting controlled entities but not their parent entities.

69. Questions to Board members related to Sections 2 and 7 would confirm whether Board members agree with staff's proposed changes in the scope of the FVM ED.

70. All other fair value measurement issues about which the Board has made tentative decisions in 2019–20 have been included in Section 1 and Sections 3–6 of this paper.

71. Two other issues are related to the scope of the FVM ED:

(a) whether to issue the FVM ED without delaying its development to address fair value measurement of concessionary ROU assets; and

(b) whether to limit the scope of the FVM ED to NFP public sector entities.

These issues are discussed in paragraphs 72–80.

Fair value measurement of right-of-use assets arising from concessionary leases

72. The Board established the FVM project in 2017 specifically to address fair value measurement issues raised by NFP public sector entities. At its November 2019 meeting, the Board extended the scope of the project to address fair value measurement of concessionary ROU assets[8] and, because that draft guidance on concessionary ROU assets was targeted for application by NFP entities in both the public and private sectors, the Board extended the scope of the FVM ED to include NFP private sector entities.

73. In 2019–20, the Board considered three versions of possible guidance for measuring the fair value of concessionary ROU assets. That draft guidance was developed based on the Board's previous tentative decision that the fair value of restricted non-financial assets (including restricted concessionary ROU assets) held primarily for their service capacity should be measured using the cost approach under certain circumstances.

74. However, if the Board agrees with staff's recommended change to the scope of the FVM ED noted in paragraph 68(b) – not to provide guidance specifically on how to measure restricted assets, including restricted concessionary ROU assets – much of the work in developing that guidance considered by the Board in 2019–20 would become redundant. Staff consider that recommencing work on that guidance would take a considerable period of time to encompass guidance on a wider range of approaches.

75. In addition, during stakeholder consultations for the purpose of responding to the IPSASB's *Request for Information – Concessionary Leases and Similar Arrangements*,[9] the Board received

8 This scope extension responded to AASB 1058 *Income of Not-for-Profit Entities* amending AASB 16 *Leases* to require concessionary ROU assets to be initially measured at fair value.

9 The AASB submission to the IPSASB can be accessed here.

comments that related non-measurement issues might warrant clarification. For example, some stakeholders commented that it is often unclear:

(a) which entity has control of the leased asset (e.g. land), particularly when a 'lessor' retains the legal title of a parcel of land but the 'lessee' is responsible for constructing a building on the land and for all maintenance and insurance costs of the building, and the lease is for an indefinite period;

(b) whether leases for zero consideration fail the definition of a lease (i.e. without consideration there is not a contract) and therefore should be outside the scope of AASB 16 *Leases*; and

(c) whether shared properties with or without a lease arrangement in place should be accounted for under AASB 16. For example, co-location arrangements between public sector entities might have a formal arrangement such as a memorandum of understanding or a shared-premises agreement, but might not be considered to be within the scope of AASB 16 because there is no specific underlying asset.

76. The IPSASB is expected to address the issues noted in paragraph 75, as well as measurement of concessionary ROU assets, in Phase Two of its Leases project. The IPSASB has indicated a plan to commence Phase Two of the project in the first quarter of 2022 and to issue an Exposure Draft in September 2022.

77. Staff consider that it would be beneficial for the Board to consider the IPSASB's forthcoming proposals regarding concessionary leases and other lease-type arrangements before developing its own guidance on those issues.

78. Staff recommend the Board defers consideration of how to measure the fair value of concessionary ROU assets and issue its FVM ED without further delay. This is because:

(a) NFP public sector stakeholders advised staff that they seek guidance as soon as possible on the FVM issues they have raised;

(b) as mentioned in paragraph 74, developing guidance on measuring fair value of concessionary ROU assets would be likely to take a considerable period;

(c) the IPSASB's Leases project would provide useful input to the Board when developing its own guidance on fair value measurement of concessionary ROU assets;

(d) how to measure the fair value of concessionary ROU assets is not an urgent issue to address because the Board further amended AASB 16 (after the initial amendment arising from AASB 1058) to provide a choice for NFP lessees to choose to initially measure concessionary ROU assets at cost instead of fair value;[10] and

(e) Government Finance Statistics (GFS) do not recognise ROU assets arising from operating leases. Therefore, to avoid creating divergence with GFS,[11] there is currently no demand for measuring such ROU assets at fair value.

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10 At the November 2021 meeting, staff also ask the Board to reconsider the initial measurement requirement of concessionary ROU assets held by NFP lessees. This is discussed in Agenda Paper 11.2.

11 The International Monetary Fund is reviewing the GFS classification of leases. However, it is uncertain when that review will be completed or what the outcome would be. Staff observe that there is little demand for specific guidance on how to measure ROU assets associated with a concessionary finance lease. This is because the nature of a finance lease – that the lessor transfers to the lessee substantially all the risks and rewards incidental to ownership of the underlying asset – would mean that the fair value of ROU assets arising from a finance lease would likely be similar to the fair value of the underlying asset.

Question for Board members

Q23: Do Board members agree with the staff recommendation in paragraph 78 to defer consideration of how to measure the fair value of concessionary ROU assets and issue its FVM ED without further delay?

Whether the proposed FVM guidance should be applicable to NFP private sector entities

79. If the Board agrees in Question 23 above to defer developing guidance on how to measure the fair value of concessionary ROU assets, staff recommend limiting the scope of the FVM ED to NFP public sector entities. This is because:

    (a) the Board has not been informed that a significant number of NFP private sector entities measure their non-financial assets at fair value under the revaluation model (noting that NFP entities would measure donated assets such as property, plant and equipment on initial recognition at fair value), or are encountering widespread and significant issues with applying the principles of AASB 13 in measuring the fair value of such assets (other than concessionary ROU assets);

    (b) the Board has not received any comments or other input regarding fair value measurement issues from NFP private sector entities in the Board's outreach activities in its FVM project or on ITC 45 regarding the IPSASB's Exposure Drafts on public sector measurement; and

    (c) extending the scope of the FVM ED to NFP private sector entities without input from this stakeholder group would risk proposing guidance that might not be relevant to these entities.

80. Staff also recommend including in the FVM ED a specific matter for comment on whether the proposals should also apply to NFP entities in the private sector.

Question for Board members

Q24: Do Board members agree with the staff recommendation in paragraph 79 that the scope of the FVM ED should be limited to NFP public sector entities?

Q25: Do Board members agree with the staff recommendation in paragraph 80 to include in the FVM ED a specific matter for comment on whether the proposals should also apply to NFP entities in the private sector?

Question for Board members

Q26: Are there any other topics Board members would like to address in the FVM ED?

Appendix: Change in scope of the draft FVM Exposure Draft

A1. In 2019–20, the Board considered three versions of the working draft FVM ED. The following table summarises the key tentative decisions the Board made regarding each measurement topic.

Topic	The Board's tentative decisions
1. How to measure restricted assets, including restricted land and concessionary ROU assets	Measure restricted assets held primary for their service capacity, including restricted land, at current replacement cost without an adjustment deducted for the public-sector-specific restricted use. This measurement is deemed to be fair value. [April 2019, June 2019, November 2019, March 2020 and April 2020 meetings.]
2. How to apply the concept of 'highest and best use' to assets held primarily for their service capacity	The highest and best use concept in AASB 13 should continue be applicable to NFP entities. However, the 'financially feasible' use aspect of a non-financial asset's highest and best use (as described in AASB 13 para. 28(c) should not be applicable to assets of NFP entities held primarily for their service capacity and measured at current replacement cost. [November 2019 meeting]
3. Treatment of restrictions affecting controlled entities but not their parent entities	If a government can rescind a law or regulation restricting the use (or pricing of the use) of a non-financial asset held by an entity it controls and does not require parliamentary approval for that rescission, the government should not measure the fair value of that asset assuming the restriction would necessarily pass to the market participant buyer, even when its controlled entity is required to assume in its own financial statements that the restriction would pass to the market participant buyer. [April 2019 meeting]
4. Assumed location of land forming part of a facility measured at current replacement cost	The replacement of an asset is always assumed to occur in its present location. [November 2019 meeting]
5. Nature of component costs to include in an asset's current replacement cost	The current replacement cost of assets composing a self-constructed facility includes all necessary costs intrinsically linked to acquiring the facility at the measurement date. An NFP public sector entity should assume that the facility presently does not exist and should take into account any make-good costs that must be incurred for surrounding facilities of another entity disturbed when the entity's facility is replaced. [November 2019 meeting]
6. Whether the current replacement cost of a self-constructed asset should include borrowing costs	No guidance is proposed for AASB 13. Include in the Basis for Conclusions of the FVM ED a statement that: In deciding whether borrowing costs should be included in the current replacement cost of a self-constructed asset, an NFP entity should consider whether a market participant buyer of the asset would include borrowing costs in its pricing decisions about the asset. The Board took the view that, in light of AASB 13 not specifying the treatment of borrowing costs for fair value measurements by for-profit entities, it would be inappropriate to mandate a particular treatment for NFP entities applying AASB 13. [June 2019 meeting]
7. How to identify and measure economic obsolescence	If an asset has suffered a reduction in demand for its services, the identification of its economic obsolescence does not require a formal decision to have been made to reduce the physical capacity of that asset. However, if an asset has apparent overcapacity in view of

Topic	The Board's tentative decisions
	current demand for its services, economic obsolescence shall not be identified for that asset if there is more than an insignificant chance that future increases in the demand for its services will largely eliminate that overcapacity within the foreseeable future. [April 2019 meeting]

Staff's proposed changes to the scope of the FVM ED

A2. Staff considered the scope of the FVM ED should be changed to:

(a) align with the Board's views expressed in its submission to the IPSASB on ED 76 *Conceptual Framework Update: Chapter 7,* Measurement of Assets and Liabilities in Financial Statements and ED 77 *Measurement*; and

(b) take into account stakeholders' requests noted in recent consultations and outreach activities.

A3. The Board noted in its submission to the IPSASB that:

(a) Accounting Standards should not mandate a particular measurement technique for measuring the current value of particular assets; and

(b) the general principles in IFRS 13/AASB 13 should be applied in selecting the measurement approach under fair value measurement of non-financial assets, including restricted non-financial assets held primarily for their service capacity.

A4. Applying that Board view noted in paragraph A3 to the Board's FVM project, staff propose the following changes to the scope of the FVM ED:

(a) Regarding Topic 1 – not to mandate a particular measurement technique for measuring the fair value of restricted assets, including restricted land and concessionary ROU assets; and

(b) Regarding Topic 3 – not addressing treatment of restrictions affecting controlled entities but not their parent entities, because that issue arose from previous Board decisions about restrictions that could affect parent and controlled entities differently – those decisions have now been reversed.

A5. In addition, the Board has received six submissions on ITC 45, which can be accessed via the hyperlinks below. Staff observed that many comments from these respondents, as well as stakeholders responding to outreach activities relating to ITC 45, related to fair value measurement of specialised assets. Therefore, staff recommend that the Board considers issuing guidance on fair value measurement of specialised assets (address in Section 2 of this paper).

1. APV Valuers & Asset Management (APV)
2. The Australian Property Institute (API)
3. The South Australian Local Government Financial Management Group (SALGFM)
4. The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)
5. The Australian Bureau of Statistics (ABS)
6. The Australasian Council of Auditors-General (ACAG)

A6. Agenda Paper 13.2 for the September 2021 meeting includes a summary of stakeholders' comments on fair value measurement obtained in the FVM project in 2019–21, as well as a summary of the five comment letters received on ITC 45 before the September 2021 meeting (excludes the ACAG letter, which was received later).