Australian Government
Australian Accounting Standards Board

Staff Paper

Note 1 to Board members

1. This working draft submission includes staff's proposed text regarding Specific Matters for Comment (SMC) 3 and 5 in ED 76 *Conceptual Framework Update: Chapter 7*, Measurement of Assets and Liabilities in Financial Statements and SMC 5, 6 and 8 in ED 77 *Measurement*.
2. **Staff recommend Board members reading the Appendices to the covering letter before reading that letter.** At this meeting, staff plan to discuss the Appendices with Board members before discussing the covering letter.
3. **As noted in Agenda Paper 5.1, any reference to stakeholder comments in this paper does not include submissions on AASB ITC 45**, **which are due to the AASB by 3 August 2021 and have yet to be received**. References to stakeholder comments in this draft submission reflect feedback the Board received during 2019-21 as part of its Fair Value Measurement for Not-for-Profit Entities project (FVM project), and targeted outreach to date on ITC 45 during June and July 2021.
4. The paper includes comment boxes to provide explanation of staff's draft text and set out the questions for Board members regarding that draft text.
5. Paragraph numbering is included in this paper for ease of reference during the Board meeting and will be removed in finalising the submission.

Mr Ross Smith
Program and Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
(submitted via the IPSASB website)

XX October 2021

Dear Ross,

IPSASB Exposure Drafts 76 and 77

6. The Australian Accounting Standards Board (AASB) is pleased to provide its comments on Exposure Draft 76 *Conceptual Framework Update: Chapter 7*, Measurement of Assets and Liabilities in Financial Statements (ED 76) and Exposure Draft 77 *Measurement* (ED 77).

7. For ease of reference in this letter, non-financial assets held primarily for their operational capacity are referred to as 'operational capacity assets'.

8. The AASB commends the IPSASB for developing proposed updated measurement concepts for public sector entities and a proposed Measurement IPSAS applying those updated concepts to a variety of measurement issues public sector entities face. This submission includes the AASB's views on selected proposals in ED 76 and ED 77, primarily regarding the current operational value measurement basis.

9. The AASB issued an Invitation to Comment (ITC 45) on ED 76 and ED 77 and received [XX] comment letters, which are available on the AASB's website.

10. Since 2013, Australian public sector for-profit and not-for-profit (NFP) entities have been applying AASB 13 *Fair Value Measurement*, which incorporates IFRS 13 *Fair Value Measurement*. Those entities apply AASB 13 to measure the current value of all their non-financial assets. Other than some disclosure relief in AASB 13 para. Aus93.1, the AASB did not make amendments to IFRS 13 for application by NFP public sector entities. Appendix A includes an overview of the experience of Australian NFP public sector entities in applying IFRS 13/AASB 13.

11. The AASB is yet to be convinced that the current value of operational capacity assets should be measured under the current operational value basis instead of the fair value basis, because it considers that:

    (a) the measurement objective for current operational value is not stated with sufficient clarity in ED 76 and ED 77; and

    (b) the IPSASB's explanation of why it concluded that fair value is appropriate for assets held primarily for their financial capacity but inappropriate for operational capacity assets should be expanded to provide better justification of that conclusion.

    Without detailed illustrative examples, it is difficult to identify how current operational value should be measured or the extent to which measurements of current operational value and fair value would differ. Overall, there is insufficient information in the Exposure Drafts to explain why current operational value would be a better measurement basis than fair value for measuring the current value of operational assets.

Question for the Board

Q1: Subject to considering submissions to be received on ITC 45, do Board members agree that the Board's submission should state that:

(a) the IPSASB's explanation of why fair value is inappropriate for operational capacity assets should be expanded;

(b) the measurement objective of current operational value (COV) is unclear;

(c) it is difficult to identify how COV should be measured or the extent to which it differs from fair value without detailed illustrative examples;

(d) overall, there is insufficient information in the Exposure Drafts to explain why COV would be a better measurement basis than fair value for measuring the current value of operational capacity assets; and therefore

(e) the Board is yet to be convinced that COV should be applied instead of fair value?

12. A significant majority of stakeholders [including those who responded to AASB ITC 45—*draft comment subject to responses*] across NFP public sector entities' financial statement preparers, auditors and valuers indicated that fair value under AASB 13 is appropriate for measuring the current value of non-financial assets held by NFP public sector entities and should remain the current value measurement basis. The Australian Federal Government and each State and Territory Government has established policies and procedures to ensure consistent application of AASB 13 within a jurisdiction. Valuers have also established procedures in preparing valuation reports required for reporting under AASB 13.

13. These stakeholders also commented that they agree with applying the 'highest and best use' and 'market participants' concepts under fair value, although some other stakeholders are seeking guidance to assist entities to understand better how these concepts should be applied in the NFP public sector context. They consider that applying the fair value basis to all non-financial assets,

despite the need to exercise judgement in applying those concepts, would be preferable to applying two measurement bases, as proposed in the ED 76 and ED 77. This is because it would avoid:

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

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

(c) reporting to users of financial statements of NFP public sector entities current values based on mixed measurement bases, which would reduce the comparability and understandability of the totals reported.

14. Appendices B and C to this letter include the AASB's responses to selected Specific Matters for Comment in ED 76 and ED 77 related to:

    (a) the current operational value measurement basis; and

    (b) the removal of certain measurement bases from the IPSASB Conceptual Framework.

15. This submission does not include views on the historical cost measurement basis or the current value measurement of liabilities and assets held for their financial capacity.

16. If you have any questions regarding this submission, please contact myself or Fridrich Housa, Deputy Technical Director (fhousa@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
AASB Chair

APPENDIX A

Overview of the experience of Australian not-for-profit public sector entities in applying IFRS 13/AASB 13

Note 2 to Board members

17. The Board decided at its June 2021 meeting that its submission should:
    (a) respond to the IPSASB's rationale why fair value is inappropriate for measuring the current value of operational assets; and
    (b) include the generally supportive feedback the Board has received from its targeted outreach to continue applying fair value to measure the current value of operational capacity assets in the Australian public sector.
18. Based on the feedback received, a majority of stakeholders commented that there would be undue costs (compared with benefits) if another measurement basis was adopted for measuring the current value of operational capacity assets.
19. According, staff have drafted Appendix A to reflect these views.

20. Since AASB 13 *Fair Value Measurement*, which incorporates IFRS 13 *Fair Value Measurement*, became effective in the 2013-14 financial year, Australian public sector entities have been applying fair value to measure the current value of all their non-financial assets. This is because the Federal, State and Territory Governments in Australia, and many of their controlled entities, have been applying the revaluation model option in Australian Accounting Standards to align with the requirements in Government Finance Statistics to measure assets and liabilities at market value. Adopting the revaluation model option in Australian Accounting Standards requires an entity to regularly revalue non-financial assets to fair value.

21. In 2016, as part of the feedback received on the AASB's Agenda Consultation 2017–2019, the AASB received requests for guidance to assist application of AASB 13 in the not-for-profit (NFP) public sector. Therefore, the AASB added the Fair Value Measurement for Not-for-Profit Entities project (FVM project) to its work program.

22. Even though guidance is being requested to clarify certain principles in measuring the fair value of specialised operational capacity assets (such as identifying the market participants for the purchase or sale of an operational capacity asset that is specialised in nature, and the highest and best use of such an asset), a significant majority of stakeholders agree that the fair value measurement basis is appropriate for measuring the current value of operational capacity assets. These stakeholders noted that the fair value basis in AASB 13 – with its three approaches to measuring fair value – caters for all non-financial assets held by public sector entities (including its incorporation of the cost approach, which is particularly appropriate for the variety of specialised assets held by public sector entities, as discussed further below). They also commented that applying the fair value basis to all non-financial assets would be preferable to applying two measurement bases, as proposed in ED 76 and ED 77. This is because it would avoid:

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

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

(c) reporting to users of financial statements of public sector entities current values based on mixed measurement bases, which would reduce the comparability and understandability of the totals reported.

Question for the Board

Q2: Subject to considering submissions to be received on ITC 45, do Board members agree that the Board's submission should include (as Appendix A) a high-level overview of the generally supportive feedback the Board has received during its FVM project and from targeted outreach on ITC 45 regarding continuing to apply fair value to measure the current value of operational capacity assets in the Australian public sector?

Identifying market participants and the highest and best use of a specialised asset

Note 3 to Board members

23. The IPSASB concluded that fair value is inappropriate for measuring the current value of operational capacity assets because it received comments from its stakeholders that the 'maximizing the use of market participant data' and the 'highest and best use' concepts are generally not applicable to the NFP public sector.

24. In its FVM project, the Board considered guidance the IASB provided on those two concepts for specialised assets. Staff see merit in providing to the IPSASB with the Board's interpretation of that IFRS 13 guidance as a basis for supporting its views that the 'hypothetical market participants' and 'highest and best use' concepts of fair value are appropriate for specialised assets of NFP public sector entities.

Tentative view about 'hypothetical market participant buyer of a restricted asset'

25. When deliberating fair value measurement of restricted assets in 2019-20, the Board reached a tentative view that the NFP public sector entity holding the restricted asset is a market participant for that asset. This is because IFRS 13 para. BC78 (quoted in paragraph 29 below) states that "… the market participant buyer steps into the shoes of the entity that holds that specialised asset".

26. The Board considered restricted operational capacity assets would typically be specialised assets (however, a majority of stakeholders disagree that restricted land is a specialised asset, which is discussed in Note 6 to Board members in Appendix C).

Highest and best use of a restricted asset

27. The Board noted that IFRS 13 paras. 29 and BC71 (quoted in paragraph 30 below) provide guidance in identifying the highest and best use of an asset. Based on these IFRS 13 paragraphs, the current use of a restricted asset is presumed to be its highest and best use, unless there is evidence that a different use by the NFP public sector entity holding the asset (as a market participant) would maximise the value of the asset.

28. Two of the key issues on which fair value guidance has been requested are:

(a) identifying the market participants for the purchase or sale of an operational capacity asset that is specialised in nature, in particular when an asset has legal restrictions (i.e. legal restrictions imposed on the use of an asset and/or the prices that may be charged for using an asset); and

(b) identifying the highest and best use of a specialised asset, including how the physical characteristics of an asset and legal restrictions should be considered when determining an asset's highest and best use.

29. The AASB has interpreted from ED 77 para. BC29 as indicating that the IPSASB decided fair value is not applicable to the current value measurement of operational capacity assets because it noted concerns from its constituents that the 'maximizing the use of market participant data' and 'highest and best use' concepts are generally not applicable to such assets. However, the AASB observed that the IASB explained in its Basis for Conclusions on IFRS 13, in paras. BC78–BC79, how to consider market participant assumptions when measuring the fair value of a specialised non-financial asset, albeit in the context of a for-profit entity holding the asset for its financial capacity (emphasis added):

BC78 Some respondents to the exposure draft expressed concerns about using an exit price notion for specialised non-financial assets that have a significant value when used together with other non-financial assets, for example in a production process, but have little value if sold for scrap to another market participant that does not have the complementary assets. They were concerned that an exit price would be based on that scrap value (particularly given the requirement to maximise the use of observable inputs, such as market prices) and would not reflect the value that an entity expects to generate by using the asset in its operations. However, IFRS 13 clarifies that this is not the case. In such situations, the scrap value for an individual asset would be irrelevant because the valuation premise assumes that the asset would be used in combination with other assets or with other assets and liabilities. Therefore, an <u>exit price reflects the sale of the asset to a market participant that has, or can obtain, the complementary assets</u> and the associated liabilities needed to use the specialised asset in its own operations. In effect, <u>the market participant buyer steps into the shoes of the entity that holds that specialised asset</u>.

BC79 It is unlikely in such a situation that a market price, if available, would capture the value that the specialised asset contributes to the business because the market price would be for an unmodified asset. <u>When a market price does not capture the characteristics of the asset</u> (eg if that price represents the use of the asset on a stand-alone basis, not installed or otherwise configured for use, rather than in combination with other assets, installed and configured for use), <u>that price will not represent fair value</u>. In such a situation, an entity will need to measure fair value using another valuation technique (such as an income approach) or <u>the cost to replace or recreate the asset</u> (such as a cost approach) depending on the circumstances and the information available.

30. Para. 29 of IFRS 13 and para. BC71 of the Basis for Conclusions on IFRS 13 provide guidance on identifying an asset's highest and best use (emphasis added):

29 Highest and best use is determined from the <u>perspective of market participants</u>, even if the entity intends a different use. However, an entity's <u>current use of a non-financial asset is presumed to be its highest and best use</u> unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

BC71 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.

31. Based on the IFRS 13 requirements and the Basis for Conclusions quoted above, the AASB made some observations regarding the 'hypothetical market participants' and 'highest and best use' concepts in respect of specialised assets and has yet to decide whether to develop fair value guidance based on these observations:

(a) because 'the market participant buyer steps into the shoes of the entity that holds that specialised asset', in the context of specialised assets, market-participants-based assumptions under fair value would be the same as the assumptions of the NFP public sector entity holding the specialised asset (interpreting IFRS 13 para. BC78). The AASB considered that a 'market participant buyer stepping into the shoes of the NFP public sector entity holding the operational capacity asset' obtains value from that asset:

i. by providing needed services to beneficiaries; and

ii. through financial support (in the form of rates, taxes, grants and appropriations) and through any user charges;

(b) the current use of a specialised asset is presumed to be its highest and best use, unless there is evidence that a different use by the NFP public sector entity holding the asset (as a market participant) would maximise the value of the asset (IFRS 13 paras. 29 and BC 71); and

(c) the income or the cost approach may be more appropriate than the market approach to measure the fair value of a specialised asset because a specialised asset should not be measured at its scrap value if the asset contributes more to an entity when used together with other assets. The market approach would reflect the selling price of the asset to an entity without the complementary assets (IFRS 13 paras. BC78 and BC79).

Question for the Board

Q3: Subject to considering submissions to be received on ITC 45, do Board members agree with highlighting to the IPSASB that the Board observed the principles stated in IFRS 13 paras. BC78–BC79 and 29 and BC71, as a basis for supporting that the 'hypothetical market participants' and 'highest and best use' concepts of fair value are appropriate for specialised assets of public sector entities?

Other aspects of fair value

32. Australian NFP public sector stakeholders have also requested the AASB to provide guidance clarifying the following issues in measuring the fair value of operational capacity assets under AASB 13:

(a) how restrictions imposed on the use of an asset and/or the prices that may be charged for using an asset should be considered when measuring fair value;

(b) the assumed location of an operational capacity asset;

(c) the nature of component costs to include in an asset's current replacement cost;

(d) whether the current replacement cost of a self-constructed asset should include borrowing costs; and

(e) consideration of obsolescence.

33. The AASB noted that Appendix B of ED 77 proposes application guidance on these issues, albeit in the context of current operational value. The AASB has included its views on these issues in its response to the Specific Matters for Comment 5–6 of ED 77, which is contained in Appendix C of this submission.

APPENDIX B

The AASB's responses to selected Specific Matters for Comment in ED 76

The AASB's views on the Specific Matters for Comment 3–5 in ED 76 are set out below.

Specific Matter for Comment 3:

Do you agree with the proposed inclusion of current operational value as a measurement basis for assets in the Conceptual Framework?

If not, why not?

The Exposure Draft includes an Alternative View on current operational value.

Note 4 to Board members

34. The draft response to SMC 3 in paragraphs 35–38 focuses on the fundamental question whether the IPSASB EDs made an adequate case for including the current operational value measurement basis in the IPSASB Conceptual Framework as an alternative to fair value and instead of replacement cost for operational capacity assets. The draft response to SMC 3 does not discuss in detail the definition of current operational value because that issue is the subject of SMCs 5–6 in ED 77.

35. The inclusion of current operational value as a measurement basis, both in a revised IPSASB Conceptual Framework and in an IPSAS on Measurement, is premised on two IPSASB decisions to measure the current value of operational capacity assets on which the AASB wishes to comment, namely:

(a) fair value is an inappropriate measurement basis; and

(b) replacement cost would be an inappropriate alternative to fair value.

36. The AASB's comments on (a) are set out below. Its comments on (b) are included in its response to Specific Matters for Comment 4 and 5 on ED 76.

37. The AASB is of the view that the IPSASB's explanation of why it concluded that fair value is appropriate for assets held primarily for their financial capacity, but inappropriate for operational capacity assets, should be expanded to provide better justification for that conclusion. Without detailed illustrative examples, it is difficult to identify how current operational value should be measured (notwithstanding ED 77's proposed Implementation Guidance on the use of experts and the meaning of 'modern equivalent asset') and, particularly, how measurements of current operational value and fair value would differ.

38. Because of the insufficiency of the justification provided, the AASB is yet to be convinced that the current value of operational capacity assets held by public sector entities should be measured under the current operational value basis instead of the fair value basis. In particular:

(a) the measurement objective for current operational value is not clearly stated in ED 76 and ED 77, particularly whether current operational value is meant to be limited to the entry price of an asset and, where not, what the nature of the measurement is;

(b) if reflecting an asset's entry value is not the sole objective of current operational value, then fair value, which measures an asset's exit value and uses the same three measurement techniques as current operational value, could be applied. As discussed in Appendix A, the IASB provided guidance (in IFRS 13 and its Basis for Conclusions thereon) for identifying market participant buyers of a specialised asset and the highest and best use of an asset when measuring fair value; and

(c) if reflecting an asset's entry value is the sole objective of current operational value, then applying replacement cost in the IPSASB's existing Conceptual Framework would appear to achieve this objective better than the proposed current operational value measurement basis (since para. 6 of ED 77 defines entry price as "the price paid to acquire an asset … in an exchange transaction" (emphasis added). In this respect, the AASB considers that the alternative definition proposed in para. AV4 of ED 77 would appear to be a clearer and more accurate definition, because it clearly states that current operational value is "the cost to replace the service potential embodied in an asset at the measurement date".

Question for the Board

Q4: Subject to considering submissions to be received on ITC 45, do Board members agree with:

(a) the staff's draft comment in paragraph 37 that the IPSASB's explanation of why it concluded that fair value is appropriate for assets held primarily for their financial capacity, but inappropriate for operational capacity assets, should be expanded to provide better justification for that conclusion; and

(b) the reasons for the proposed Board comment set out in paragraphs 37–38?

Specific Matter for Comment 4:

It is proposed to substitute a general description of value in use (VIU) in both cash-generating and non-cash-generating contexts, for the previous broader discussion of VIU. This is because the applicability of VIU is limited to impairments. Do you agree with this proposed change?

If not, why not? How would you approach VIU instead and why?

[SMC 4 to be discussed at September meeting]

Specific Matter for Comment 5:

Noting that ED 77, Measurement, proposes the use of the cost approach and the market approach as measurement techniques, do you agree with the proposed deletion of the following measurement bases from the Conceptual Framework:

- Market value—for assets and liabilities; and
- Replacement cost—for assets?

If not, which would you retain and why?

Note 5 to Board members

39. ED 76 proposes to remove two measurement bases from the IPSASB Conceptual Framework based on its conclusion that those bases would become redundant as a result of adding fair value and current operational value as measurement bases. The staff draft response differs for those proposals.

40. The staff draft response (paragraph 42 below) supports the deletion of 'market value' from the IPSASB Conceptual Framework. This is because fair value is widely accepted as providing relevant

current value information and is already included in IPSAS (albeit with an outdated definition – which the IPSASB proposes to update in ED 76 and ED 77). The IASB Revised Conceptual Framework does not include ‘market value’ as a current value measurement basis.

41. In contrast, the staff draft response regarding the proposed deletion of replacement cost from the IPSASB Conceptual Framework (paragraphs 43–47 below) argues that a convincing case has not been made for replacing it with current operational value, for the reasons given in those paragraphs.

Deletion of market value

42. The AASB agrees with the proposed deletion of ‘market value’ from the IPSASB Conceptual Framework as a measurement basis for assets and liabilities in light of the IPSASB’s proposals to:

(a) include fair value as a measurement basis in the Conceptual Framework; and

(b) conform the definition of ‘fair value’ – both in the IPSASB Conceptual Framework and the Measurement IPSAS – to that used in IFRS 13, thus removing the need to use ‘market value’ to avoid potential confusion from including the IPSAS definition of ‘fair value’ in the Conceptual Framework rather than the definition in IFRS 13 (refer paras. BC7.31 and BC7.59–BC7.60 of the Basis for Conclusions on ED 76, and paras. BC51–BC54 of the Basis for Conclusions on ED 77).

Deletion of replacement cost

43. The AASB considers that the reasons given in ED 76 and ED 77 for proposing to remove replacement cost as a current value measurement basis should be expanded to provide better justification for that proposal. Based on the reasons presented, a convincing argument has not been provided for removing replacement cost. This AASB view reflects the following aspects:

(a) current operational value is meant to reflect an entry price (ED 77 para. B9);

(b) the IPSASB’s proposals include using the cost approach as a measurement technique to estimate current operational value (ED 77 para. 38); and

(c) the IASB includes current cost (as a complement to fair value and value in use)—which is similar to replacement cost—as a current value measurement basis in its Conceptual Framework.

44. ED 76 para. BC7.33 states that the IPSASB considered that replacement cost is an appropriate measurement basis for specialised assets, but also that current operational value is a more versatile measurement basis as it can be applied to both specialised and non-specialised assets. ED 76 para. BC7.27 states that the current operational value of a non-specialised asset can be supported by market-based measurement techniques with similarities to market value; whereas, the current operational value of a specialised asset can be determined using other measurement techniques.

45. The AASB interprets the IPSASB’s rationale for not supporting ‘replacement cost’ as a measurement basis, noted in the first sentence of the paragraph immediately above, to imply replacement cost is inapplicable to assets valued using market techniques. That is, the IPSASB’s rationale seems to regard replacement cost and market prices as mutually exclusive values. If that is the IPSASB’s reasoning, the AASB would not support it.

46. The AASB considers the notion of replacement cost (whether measured under the cost approach to fair value or under another measurement basis) to be derived solely from market transactions, some of which might not be observable in an active market (e.g. where a specialised asset would be replaced through a multitude of individual purchases of materials and labour). Prior to adopting IFRS

in Australia, various Australian public sector entities adopted a current-cost-based revaluation model (using guidelines similar to, or concordant with, Statement of Accounting Practice SAP 1 *Current Cost Accounting*), under which the 'current cost' of assets was measured using market prices. Therefore, the AASB considers that the notion of replacement cost is sufficiently robust to be applied to assets that are, or are not, traded in an active market.

47. An important advantage of retaining replacement cost as a current value measurement basis in the IPSASB Conceptual Framework, and including it in the IPSAS on Measurement, would be that many preparers, valuers and auditors of financial statements of public sector entities are familiar with replacement cost in the existing IPSASB Conceptual Framework and the existing role of depreciated replacement cost as a measure of fair value[1] in IPSAS 17 *Property, Plant and Equipment* (para. 48). Adopting a new measurement basis such as current operational value would involve developing new measurement techniques and identifying exactly how current value measurements of operational capacity assets would change. This would be difficult in the absence of detailed illustrative examples of how to measure an asset's current operational value. In addition, if current operational value was intended to measure an asset's current entry value, it would seem that its differences from replacement cost should be minimal, in which case it is difficult to envisage how the benefits of changing to a subtly different current value measurement basis for operational capacity assets would exceed the resulting costs.

Question for the Board

Q5: Subject to considering submissions to be received on ITC 45, do Board members agree with:

(a) the staff's draft comment in paragraph 42 that the IPSASB's proposal to delete 'market value' from the measurement bases in the IPSASB Conceptual Framework is supported;

(b) the staff's draft comment in paragraph 43 that the reasons given in ED 76 and ED 77 for proposing to remove 'replacement cost' from the IPSASB Conceptual Framework should be expanded to provide better justification for that proposal; and

(c) the reasons for the proposed Board comments set out in paragraphs 42–47?

[1] Albeit, applying the cost approach involves using 'current replacement cost' (CRC) rather than 'depreciated replacement cost' (DRC); replacing 'DRC' with 'CRC' would remove the potential for confusion regarding the distinction between those terms.

APPENDIX C

The AASB's responses to selected Specific Matters for Comment in ED 77

The AASB's views on the Specific Matters for Comment 5–9 in ED 77 are set out below.

Specific Matter for Comment 5:

Do you agree current operational value is the value of an asset used to achieve the entity's service delivery objectives at the measurement date?

If not, please provide your reasons, stating clearly what principles more appropriate for the public sector, and why.

The Exposure Draft includes an Alternative View on current operational value.

Specific Matter for Comment 6:

Do you agree the proposed definition of current operational value and the accompanying guidance is appropriate for public sector entities (Appendix B: Current Operational Value)?

If not, please provide your reasons, stating clearly what definition and guidance is more appropriate, and why.

The AASB's comments on the proposed core principle of 'current operational value' (Specific Matter for Comment 5) and how the proposed definition of 'current operational value' encapsulates that core principle (Specific Matter for Comment 6) are set out jointly below in Part A of the AASB's comments on those Specific Matters for Comment.

The AASB's comments on the proposed accompanying guidance on 'current operational value' in Appendix B of ED 77 (Specific Matter for Comment 6) are set out below in Part B of the AASB's comments on those Specific Matters for Comment.

Part A: Proposed core principle and definition of 'current operational value'

Measurement objective and definition of current operational value

48. ED 77 para. 25(a) states that current operational value is an entry value. Similarly, ED 77 para. B2(a) states that: "… current operational value <u>reflects the amount an entity would incur at the measurement date to acquire its existing assets</u> to be able to continue to achieve its present service delivery objectives …" (emphasis added). This states that current operational value reflects an asset's replacement cost.

49. However, ED 76 and ED 77 rejected replacement cost (and current cost in the IASB Conceptual Framework) as a possible alternative current value measurement basis to fair value for operational capacity assets. This indicates a measurement basis other than replacement cost would sometimes be used, but the Exposure Drafts do not identify the extent to which (or the circumstances in which) current operational value measurements would differ from replacement cost. It also implies a measurement objective other than replacement cost for some operational capacity assets, without identifying what that alternative objective might be. This is because the proposed definition of current operational value, as stated in ED 77 para. 6 ("the value of an asset used to achieve the entity's service delivery objectives at the measurement date") does not specify the type of 'value'.

50. Because the stem of ED 77 para. B2 states that "current operational value measures <u>the value to the entity</u> of an asset …" (emphasis added), and ED 76 and ED 77 reject fair value (a market exit price) and replacement cost (a market entry price) as the current value measurement basis for operational

capacity assets, a potential implication is that Exposure Drafts propose some kind of intrinsic value measure of service potential for operational capacity assets. The AASB would not support using an intrinsic non-market current value measure because:

(a) any transactions undertaken by an entity to sell or replace its assets will occur at market prices; and

(b) it would be inherently subjective.

51. For the reasons in paragraphs 48–50, the AASB considers that:

(a) ED 76 and ED 77 appear to contain some inconsistencies in respect of the measurement objective of current operational value; and

(b) the meaning of current operational value warrants further clarification. Without further clarification, including detailed illustrative examples, it is difficult to identify the measurement objective of current operational value and how it should be applied in all circumstances.

52. In this regard, the AASB supports the observation noted in the Alternative View in ED 77 para. AV14 that permitting the use of the income approach in estimating current operational value would mean that the resulting valuation might not reflect an entry price. Para. 6 of ED 77 defines entry price as " the price paid to acquire an asset … in an exchange transaction" (emphasis added). In the context of an operational capacity asset, it is difficult to understand how the use of the income approach, which is a measurement based on the cash flows generated by an asset, would reflect its entry price.

53. If the sole measurement objective of current operational value is to reflect an entry value of the asset, then the alternative definition proposed in para. AV4 of ED 77 would appear to be a clearer and more accurate definition, because it clearly states that current operational value is "the cost to replace the service potential embodied in an asset at the measurement date" (emphasis added).

Question for the Board

Q6: Subject to considering submissions to be received on ITC 45, do Board members agree that the Board's submission should state that:

(a) ED 76 and ED 77 are unclear whether:

i. COV is a measure of the cost required to replace the service potential of an asset or an intrinsic value to the entity of an asset's remaining service potential; and

ii. COV is meant to be limited to the entry price of an asset and, where not, what the nature of the measurement is; and

(b) if reflecting an asset's entry value is the sole objective of COV, the AASB would support the observation noted in the Alternative View in ED 77 para. AV14 that permitting the use of the income approach in estimating current operational value would mean that the resulting valuation might not reflect an entry price?

Current value measurement disregards an asset's potential alternative uses

54. Another potential inconsistency the AASB noted is the proposal that current operational value:

(a) disregards potential alternative uses and any other characteristics of the asset that could maximise its market value (ED 77 para. B4); yet

(b) it "… provides a useful measure of the resources available to provide services in future periods …" (ED 76 para. 7.53, emphasis added).

55. The phrase "resources available to provide services in future periods" in ED 76 para. 7.53 would logically include the asset's residual value (i.e. its potential to be sold for cash at the end of its useful life and be reinvested in other stores of service potential). This viewpoint is consistent with the IPSASB's replacement cost measurement basis in its existing Conceptual Framework, which the IPSASB treats in ED 76 para. BC7.33 as appropriate for specialised assets. Para. 7.37 of the IPSASB Conceptual Framework states that an asset's replacement cost includes the amount that an entity will receive from disposal of the asset at the end of its useful life. The AASB recommends the IPSASB clarifies whether an asset's residual value is included in its current operational value.

56. For example, the current value of a post office (an operational capacity asset) in the centre of a large city with the potential to be used as a commercial building with a high resale value should exceed the current value of another post office located in an outer suburb with no potential alternative uses and a low resale value. Even if the two post offices have an identical capacity to provide postal services and identical remaining useful lives, the post office located in the city centre has the potential to provide more services (directly and indirectly) to the entity because the entity could choose to sell it and reinvest the cash in other post offices.

57. In addition, if the objective of current value measurement is to provide a "useful measure of the resources available to provide services in future periods" (ED 76 para. 7.53), the measurement should be based on the use of the asset that would maximise the value of the asset to the entity. For example, a non-specialised building with harbour views currently being used by a public sector entity as a storage space has an alternative use as a residential property without requiring a change of permitted use. Under the market approach, the current value of this building would be likely to be measured based on market prices of comparable buildings, which would be a residential building.

Question for the Board

Q7: Subject to considering submissions to be received on ITC 45, do Board members agree that the Board's submission should state that:

(a) ED 76 and ED 77 appear to be inconsistent because ED 77 para. B4 requires a measure of COV to disregard potential alternative uses and any other characteristics of the asset that could maximise its market value, and yet ED 76 para. 7.53 describes COV as providing a useful measure of the resources available to provide services in future periods; and

(b) If COV is meant to provide a useful measure of "resources available to provide services in future periods" then it would logically include the asset's residual value (i.e. its potential to be sold for cash at the end of its useful life and be reinvested in other stores of service potential)?

Current operational value of restricted operational capacity assets

Note 6 to Board members

58. The mandatory guidance in para. B14 of ED 77 proposes that the cost approach should be applied in measuring COV of restricted assets if an equivalent restricted asset is not obtainable at the measurement date for a price supported by observable market evidence – this is consistent with the Board's tentative view in 2019-20 noted in paragraph 61, on which some Board members have expressed alternative views at the June 2021 meeting.

59. In addition, non-mandatory implementation guidance proposed in para. IG19 in ED 78 *Property, Plant and Equipment* would suggest that the current value (under current operational value or fair value) of land under or over specialised assets should be measured using the cost approach.

60. Since the Board has decided to provide comments on all aspects of COV, this section discusses the content of the Board's submission in respond to those IPSASB's proposals.

Tentative decision on fair value measurement of restricted assets

61. In 2019-20, the Board made a tentative decision that the fair value of restricted assets, including restricted land, should be measured using the cost approach, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. The Board's tentative view was also that, under the cost approach, the price of the equivalent unrestricted asset should not be reduced for the effect of the restrictions, to measure the amount deemed to be the fair value of the restricted asset (see Action Alert of the April 2019 and November 2019 meetings).

62. The Board reached the tentative decision having regard to the following:

(a) based on the interpretation of the IASB's view in IFRS 13 para. BC 78 (quoted in paragraph 29 in Appendix A), many restricted assets might have little value if sold for scrap, but would have a significant value when used together with other non-financial assets. In this regard, the Board considered that a 'market participant buyer stepping into the shoes of the NFP public sector entity holding the restricted asset' obtains value from that asset:

i. by providing needed services to beneficiaries; and

ii. through financial support (in the form of rates, taxes, grants and appropriations) and through any user charges;

(b) applying the market approach has led to the fair value of some restricted land (e.g. land under dams) being measured at a very low value (at scrap value), which does not appear to fairly represent the service potential of those assets unless that service potential is subsumed within the measurement of another asset (e.g. some argue that the service potential of land under dams is subsumed within the value of water or water rights held);

(c) conceptually, if an equivalent restricted asset is not obtainable at the measurement date, the market approach cannot be applied. This is because AASB 13 Appendix A defines the market approach as "a valuation technique that uses prices and other relevant information generated by market transactions involving <u>identical or comparable</u> (ie similar) assets ..." (emphasis added);

(d) AASB 13 Appendix A defines the cost approach as "a valuation technique that reflects the <u>amount that would be required currently to replace the service capacity of an asset</u> …" (emphasis added). Under the cost approach, if an entity needs to purchase an unrestricted asset to replace the service capacity of an asset, then the fair value should be based on the price for the replacement unrestricted asset, which should not be reduced for the effect of restrictions. This is because the restrictions would not reduce the amount the entity would need to incur to replace the service capacity of the asset; and

(e) the view noted in para. 62(d) above is generally accepted when measuring the current value of the specialised improvements on the land (i.e. measure the fair value of specialised improvements using the cost approach and the valuation does not incorporate a reduction for the effect of restrictions). Thus, the Board preferred a consistent application of AASB 13 principles across assets with a similar specialised nature.

63. The Board noted that, if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, the market approach should be applied.

Feedback received to date regarding the tentative decision

64. Since making the tentative decision to mandate the cost approach in measuring restricted assets if an equivalent restricted asset is not obtainable at the measurement date for a price supported by observable market evidence, the Board has received the following comments from a significant majority of prepares and auditors of public sector entities financial statements, and valuers who commented on this issue in targeted outreach or ad hoc feedback on tentative Board decisions:
    (a) although the terms 'restricted assets' and 'specialised assets' are not defined in AASB 13, most public sector properties and infrastructure that have legal public-sector-specific restrictions imposed on the use of the asset and/or the prices that may be charged for using the asset are considered specialised assets. The fair value of specialised assets is typically measured using the cost approach;
    (b) however, they do not consider restricted land to be a specialised asset and, therefore, consider that applying the market approach is more appropriate. Although an equivalent parcel of land with the same restrictions (with the same zoning restrictions as the specialised assets over or under the land) might not be obtainable in the marketplace at the measurement date, there are market transactions for other parcels of land that are suitable reference assets;
    (c) consistent with 64(b), a significant majority of fair value measurements of restricted land currently recognised in public sector entities' financial statements use the market approach with the valuations reduced for the effect of restrictions;
    (d) if the cost approach was mandated for measuring restricted land, it would likely have a significant effect on:
        i. public sector entities' balance sheets (the reported values of restricted land would increase); and
        ii. currently used valuation processes and procedures;
    (e) they would prefer that significant changes to current practice are not imposed regarding fair value measurements of restricted assets;
    (f) the Board should reconsider whether the costs required to change current practice would outweigh the benefits, and whether the increase in reported values of restricted land (if the Board's tentative decision noted in paragraph 61 was adopted) would satisfy the information needs of users of financial statements; and
    (g) a principles-based Standard should not mandate a particular valuation approach to measure a particular asset class. It should allow the ability to apply judgement of the circumstances to choose among the appropriate measurement approaches for measuring the fair value of an asset.
65. In the 2020 targeted outreach discussions with users of public sector entities' financial statements, the Board received comments from 19 (of 49 contacted) respondents. Some of those respondents are users of financial data rather than users of financial statements, that is, they focus on aggregated data at the Whole of Government level.
66. Amongst other questions, users of financial statements or financial data were asked whether they would prefer public sector entities' financial statements to reflect restricted land's current service

potential or the amount of net cash inflows that restricted land currently is able to generate under its restricted use. Eighteen of the 19 respondents expressed a preference. It was noted that:[2]

(a) Of the 19 respondents, 13 would prefer financial statements to reflect the amount of net cash inflows that restricted land currently is able to generate under its restricted use. A majority of the 13 respondents consider that most restricted land has a low likelihood of being allowed to be sold (e.g. until identified as a surplus asset) and, therefore, think financial statements should not be overstated by reflecting asset values that cannot be realised while the land remains restricted. Some of the 13 respondents commented that, when using financial data, they focus on cash flows and expenditure rather than balance sheet information. They are interested in knowing the value of assets that could be sold to support budget outcomes and debt repayment.

(b) Five of the 19 respondents commented that financial statements should reflect the current service potential of assets in some way, and that any self-imposed restrictions or restrictions that can be removed through rezoning are irrelevant when reporting the land's value most useful to users of the financial statements. However, some of these respondents also commented that many restricted assets cannot be liquidated by a local government and reporting an asset at an unrealisable amount might not be of particular public value.

Comments expressed by some Board members in June 2021 meeting

67. Staff observed from the June 2021 meeting that some Board members have expressed a view about whether there is a need to amend the requirements of AASB 13 if:

(a) the principles are largely working well for Australian public sector entities; and

(b) the application of AASB 13 is largely consistent.

68. Staff have interpreted those comments to mean that those Board members may want the Board to reconsider its tentative views reached in 2019-20 noted in para. 61, and are of the view that public sector entities' choice of using the market, income or cost approach to measure the fair value of restricted assets (or other assets) should not be circumscribed in any way. That is:

(a) the cost approach should not be mandated for some or all restricted non-financial assets; and

(b) public sector entities should be able to elect to use the income, market or cost approach to measure the fair value of any non-financial asset, including an operational capacity asset.

Staff note that the Board plans to consider implications of comments received on ITC 45 for the direction of future work on the FVM project at its November 2021 meeting.

Explanation of staff's draft text

69. Staff present below for the Board's consideration five options for how it responds to the IPSASB's proposals noted in para. 58–59.

70. Staff have included draft text for the five options, as explained below. For all five options, staff propose that the Board provides the IPSASB with a summary of feedback received from stakeholders regarding fair value measurement of restricted assets noted in para. 64:

[2] A high-level summary of feedback from users is contained in paragraphs 20–27 of Agenda Paper 4.2 for the November 2020 meeting. That agenda paper noted comments from 17 users; the Board received an oral update about the comments made by the other two users during the November 2020 meeting.

- Option 1: not expressing a AASB view about current value measurement of restricted assets (that is, only provide the IPSASB with a summary of feedback received from stakeholders regarding fair value measurement of restricted assets);
- Option 2A: express a view based on the Board's tentative decision to mandate the use of the cost approach in measuring restricted assets under certain circumstances, which aligns with the proposals in ED 77;
- Option 2B: express a view based on Option 2A, but also include rationale for the alternative view (noted in Option 3A) expressed by some Board members, to present both sides of the debate;
- Option 3A: express a view based on the alternative views expressed by some Board members in the June 2021 meeting and consistent with the majority of stakeholder feedback from the FVM project to date, that the selection of the measurement approaches to measure the fair value of restricted assets (or other assets) should not be circumscribed in any way; and
- Option 3B: express a view based on Option 3A, but also include rationale for the Board's tentative decision (noted for Option 2A) to present both sides of the debate.

71. Staff included Options 2B and 3B because the IPSASB's proposals align with the Board's tentative decision reached in 2019-20 and it might be useful for the IPSASB to see both sides of the debate.

72. Because ED 76 and ED 77 are not clear about the measurement objective of COV, staff recommend the Board provides feedback to the IPSASB in the context of fair value regarding the current value measurement of restricted assets.

73. Staff have not included a recommendation on which Option should be selected if the Board decides to comment on the IPSASB proposals noted in para. 58–59. This is because staff's understanding of the Board members' comments at the June 2021 meeting (noted in para. 67–68) is that they would represent a significant change from the tentative Board decision about restricted assets. For staff to develop a recommendation in response would require consideration of submissions yet to be received on ITC 45, and would require greater depth of analysis than possible within the timeframe for developing this working draft submission. However, the absence of a staff recommendation does not preclude the Board from making a tentative decision on this issue for the purposes of its submission to IPSASB (subject to considering submissions to be received on ITC 45).

Draft text of Option 1 – a summary of feedback received from stakeholders regarding fair value measurement of restricted assets

74. ED 77 para. B14(b) proposes that, if an equivalent restricted asset is not obtainable in an orderly market at the measurement date for a price supported by observable market evidence, the asset is measured using the cost approach, at the price of an equivalent unrestricted asset without a reduction for the restrictions. Without detailed illustrative examples, the AASB cannot identify the extent to which such a restricted asset's fair value would differ from its COV. The AASB's comments regarding the current value measurement of restricted assets are expressed in the context of fair value.

75. The topic of fair value measurement of restricted land held by an NFP public sector entity for its operational capacity has attracted extensive debate in the AASB's FVM project. Therefore, although this submission is specific to the proposals in ED 76 and ED 77, the non-mandatory implementation guidance in ED 78 *Property, Plant and Equipment* regarding measurement of land under or over specialised assets – applicable to both current operational value and fair value – is also relevant to this topic.

76. The AASB observed that the guidance in ED 78 para. IG19 would suggest that the current value (current operational value or fair value) of land under or over specialised assets should be measured using the cost approach (emphasis added):

IG19. [Draft] IPSAS [X] (ED 78) is clear that:

(a) Land should be separately accounted for. This requirement applies to all land, including land under or over infrastructure assets; and

(b) Land under or over infrastructure assets accounted for under the current value model should be valued at current operational value or fair value. Because the infrastructure asset itself is a specialized asset, it will often be the case that the market approach will be challenging to apply, and that the asset will be more easily valued using the cost approach.

77. Consistent with ED 77 para. 14(a), if an equivalent restricted asset is obtainable in the marketplace at the measurement date for a price supported by observable market evidence, most Australian stakeholders agree that the market approach should be applied in measuring the current value of the restricted asset.

78. Where equivalent restricted land is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence, based on targeted outreach with valuers, financial statements preparers and auditors [and comments received on AASB ITC 45—*draft, subject to responses*], the AASB noted that:

(a) land and improvements on land are recognised as separate classes of assets;

(b) a minority of stakeholders consider that restricted land is a specialised asset, and the fair value of restricted land should be measured in a manner similar to that described in ED 77 para. B14(b). That is, the cost approach should be applied and the current value of restricted land should not be reduced for the effect of restrictions; however,

(c) a clear majority of fair value measurements of restricted land are measured using the market approach. Under the market approach, the fair value measurements are less than the market price of equivalent unrestricted land[3] because of the effect of the restrictions. That is, the fair value of restricted land is measured at an amount less than the sales price of equivalent nearby unrestricted land.

79. Stakeholders applying the majority approach described in (c) above would disagree with ED 78 para. IG 19(b) about applying the cost approach to measure the fair value of land under or over specialised assets (e.g. land under a hospital) because:

(a) they do not consider land under or over specialised assets to be a specialised asset; and

(b) although an equivalent parcel of land with the same restrictions (with the same zoning restrictions as the specialised assets over or under the land) might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence,

3 That is, not restricted for the public-sector-specific purpose for holding the entity's parcel of land being valued. The equivalent 'unrestricted' land might be restricted in use by zoning otherwise 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.

there are market transactions for other parcels of land that are suitable reference assets. Therefore, those stakeholders consider there are more observable inputs for applying the market approach than the cost approach in measuring the fair value of restricted land (consistent with the proposal in para. B23 of ED 77 to maximise the use of relevant observable inputs and minimise the use of unobservable inputs).

80. In respect of specialised improvements on land (e.g. a hospital building), a majority of Australian stakeholders would support the proposal regarding infrastructure in para. IG19(b) and apply the cost approach to measure the fair value of specialised improvements. This is because identical or comparable assets might not be available in the marketplace and, as stipulated in IFRS 13 para. BC79 (discussed in Appendix A), a market price (using the market approach) – if available – might not capture the characteristics of the specialised asset and therefore would not represent fair value. This treatment is applied regardless of whether the market approach or the cost approach is applied to measure the fair value of restricted land.

81. Australian stakeholders have also advised the AASB that different valuers use different methods in calculating the adjustments to be deducted from the market price of equivalent unrestricted land, for example:

    (a) using the price of nearby unrestricted land and explicitly deducting an adjustment for the effect of the restriction (explicit adjustment); and

    (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).

<u>Additional text to be included for Option 2A – propose that the use of the cost approach should be mandated in measuring restricted assets under certain circumstances</u>

Note 7 to Board members Draft text for Option 2A would include: (a) a summary of feedback received from stakeholders regarding fair value measurement of restricted assets (draft text for Option 1 in paragraphs 74–81); and (b) the additional text in paragraphs 82–85.

82. The AASB is of the view that many restricted assets might have little value if sold for scrap, but would have a significant value when used together with other non-financial assets. In this regard, based on the interpretation of the IASB's view in IFRS 13 para. BC 78 (quoted in Appendix A), the AASB considered that a 'market participant buyer stepping into the shoes of the NFP public sector entity holding the restricted asset' obtains value from that asset:

    (a) by providing needed services to beneficiaries; and

    (b) through financial support (in the form of rates, taxes, grants and appropriations) and through any user charges.

83. Conceptually, if an equivalent restricted asset is not obtainable at the measurement date, the market approach cannot be applied. This is because IFRS 13 defines the market approach as "a valuation technique that uses prices and other relevant information generated by market transactions involving <u>identical or comparable</u> (ie similar) assets ..." (emphasis added). The AASB notes that the

IASB also acknowledged in IFRS 13 para. BC79 that the cost or income approach might be more appropriate in measuring an asset's fair value when a market price does not capture the characteristics of the asset. The example the IASB noted in that basis for conclusion is when the market price of the asset represents the use of the asset on a stand-alone basis rather than in combination with complementary assets.

84. IFRS 13 defines the cost approach as "a valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset …" (emphasis added). Consistent with the IPSASB's view explained in ED 77 paras. B17 and BC44–BC45, if equivalent restricted land is not obtainable in the marketplace, the entity would need to purchase unrestricted replacement land to continue delivering services and the existence of restrictions does not affect the price of this purchase. Therefore, under the cost approach, if an entity needs to purchase an unrestricted asset to replace the service capacity of an asset, then the fair value should be based on the price for the replacement unrestricted asset, which should not be reduced for the effect of restrictions.

85. The AASB has reached a tentative view that the fair value of restricted assets should be measured using the cost approach without a reduction for the effect of the restrictions, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence.

Option 2B – propose that the use of the cost approach should be mandated in measuring restricted assets under certain circumstances, but also explain that some Board members have expressed alternative views consistent with the majority of stakeholder feedback from the FVM project to date

Note 8 to Board members

Draft text for Option 2B would include:

(a) a summary of feedback received from stakeholders regarding fair value measurement of restricted assets (draft text for Option 1 in paragraphs 74–81);

(b) paragraphs 86–88 of the additional text for Option 3A;

(c) a linking paragraph: "Notwithstanding the comments received from stakeholders, the AASB considers that the fair value of a restricted asset should be measured using the cost approach without a reduction for the effect of restrictions, if an equivalent restricted asset is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence."; and

(d) additional text for Option 2A in paragraphs 82–85.

Additional text to be included for Option 3A – propose that the selection of the measurement approaches to measure fair value of restricted assets (or other assets) should not be circumscribed in any way

Note 9 to Board members

Draft text for Option 3A would include:

(a) a summary of feedback received from stakeholders regarding fair value measurement of restricted assets (draft text for Option 1 in paragraphs 74–81); and

(b) the additional text in paragraphs 86–89.

86. Para. B23 of ED 77 proposes to require an entity to select measurement techniques:

    (a) that are appropriate in the circumstances;

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

    (c) maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

87. IFRS 13 para. 61 has the same requirement for measuring an asset's fair value. A majority of Australian stakeholders [who responded to ITC 45*: draft, subject to comment letters received*] 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) works well for measuring the fair value of an asset.

88. Despite the debate, feedback from most Australian stakeholders in targeted outreach or ad hoc feedback on tentative Board decisions 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, an adjustment is deducted (explicitly or implicitly) from the market price of equivalent unrestricted land to reflect the effect of restrictions because the market approach is used (although different methods are being used: see below); and

    (b) for restricted improvements on land, an adjustment is not deducted to reflect the effect of restriction because the cost approach is used.

89. The AASB considers that determining appropriate valuation techniques for measuring the current value of an asset that is restricted, or integrated with a specialised asset, is best regarded as belonging within the province of valuation professionals and should not be mandated in 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 current value of a particular asset or asset class.

<u>Option 3B – propose that the selection of the measurement approaches to measure fair value of restricted assets (or other assets) should not be circumscribed in any way, but also explain the Board's tentative view reached in 2019-20</u>

Note 10 to Board members

Draft text for Option 3B would include:

(a) a summary of feedback received from stakeholders regarding fair value measurement of restricted assets (draft text for Option 1 in paragraphs 74–81);

(b) additional text for Option 2A in paragraphs 82–85, but expressed as views noted by the Board, rather than held by the Board;

(c) a linking paragraph: "Despite reaching a tentative view in 2019-20 that the fair value of restricted assets should be measured using the cost approach under certain circumstances, the AASB considers that determining appropriate valuation techniques for measuring the current value of an asset is best regarded as belonging within the province of valuation professionals and should not be mandated in accounting standards."; and

(d) additional text for Option 3A in paragraphs 86–89.

Questions for the Board

Subject to considering submissions to be received on ITC 45:

Q8: Do Board members agree to comment on the proposal in ED 77 – that the cost approach should be applied in measuring the COV of restricted assets if an equivalent restricted asset is not obtainable at the measurement date for a price supported by observable market evidence? This is consistent with the Board's tentative view in 2019-20 noted in para. 61, on which some Board members have expressed alternative views (also expressed by the stakeholders during the FVM project) at the June 2021 meeting.

Q9: If Board members agree in Q8 to provide comments to the IPSASB in respect of current value measurement of restricted assets, do Board members agree to express a view in the context of fair value instead of COV?

Q10: In respect of current value measurement of restricted assets, which of the following options do Board members prefer to be included in its submission:

- Option 1: not expressing a AASB view about current value measurement of restricted assets (that is, only provide the IPSASB with a summary of feedback received from stakeholders regarding fair value measurement of restricted assets);
- Option 2A: express a view based on the Board's tentative decision to mandate the use of the cost approach in measuring restricted assets under certain circumstances, which aligns with the proposals in ED 77;
- Option 2B: express a view based on Option 2A, but also include rationale for the alternative view (noted in Option 3A) expressed by some Board members, to present both sides of the debate;
- Option 3A: express a view based on the alternative views expressed by some Board members in the June 2021 meeting that the selection of the measurement approaches to measure the fair value of restricted assets (or other assets) should not be circumscribed in any way; or
- Option 3B: express a view based on Option 3A, but also include rationale for the Board's tentative decision (noted for Option 2A) to present both sides of the debate?

Q11: Do Board members agree with the content of the draft text for the option they prefer?

Part B: Proposed accompanying guidance on 'current operational value' in Appendix B of ED 77

Nature of component costs to include in an asset's current replacement cost

[To be discussed at the September 2021 meeting.]

Whether the current replacement cost of a self-constructed asset should include borrowing costs

[To be discussed at the September 2021 meeting.]

Consideration of obsolescence when determining current operational value

[To be discussed at the September 2021 meeting.]

Specific Matter for Comment 7:

Do you agree the asset's current operational value should assume that the notional replacement will be situated in the same location as the existing asset is situated or used?

If not, please provide your reasons, stating clearly why the asset should be measured at a different value.

[To be discussed at the September 2021 meeting.]

Specific Matter for Comment 8:

Do you agree the income approach is applicable to estimate the value of an asset measured using the current operational value measurement basis?

If not, please provide your reasons, stating clearly why the income approach is not applicable for measuring current operational value.

The Exposure Draft includes an Alternative View on current operational value.

Note 11 to Board members

90. Staff's draft text is consistent with the draft text in paragraphs 48–53 of the reply to SMCs 5–6.

91. As mentioned in our responses to SMC 5 and SMC 6, there appear to be some inconsistencies in respect of the measurement objective for current operational value. In particular, it is unclear whether current operational value is meant to be limited to the entry price of an asset and, where not, what the nature of the measurement is.

92. If reflecting an asset's entry value is the sole objective of current operational value, the AASB would support the observation noted in the Alternative View in ED 77 para. AV14 that permitting the use of the income approach in estimating current operational value would mean that the resulting valuation might not reflect an entry price.

Question for the Board

Q12: Subject to considering submissions to be received on ITC 45, do Board members agree with the draft text for SMC 8?

Specific Matter for Comment 9:

In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on fair value has been aligned with IFRS 13, *Fair Value Measurement* (Appendix C: Fair Value). Do you agree the guidance is appropriate for application by public sector entities?

If not, please provide your reasons, stating what guidance should be added or removed, and why.

[To be discussed at the September 2021 meeting.]