



<b>Project:</b>	<b>Fair Value Measurement for Public Sector Entities</b>	<b>Meeting:</b>	AASB June 2019 (M171)
<b>Topic:</b>	<b>Draft ED and items for Discussion</b>	<b>Date:</b>	30 May 2019
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		<b>Project Priority:</b>	Medium
		<b>Decision-Making:</b>	Medium
		<b>Project Status:</b>	Form tentative views on issues discussed

## Objective of this agenda item

1. The objective of this agenda item is for the Board to consider a working draft of a proposed Exposure Draft of guidance accompanying AASB 13 *Fair Value Measurement* for application by not-for-profit public sector entities (Agenda Paper 6.2), and to **decide** whether:
  - the draft amendment in the ED and the accompanying draft illustrative example reflect the decision by the Board in the April 2019 meeting to modify AASB 13 to state that for non-financial assets held by not-for-public sector entities for their service capacity and not primarily for their ability to generate net cash inflows, the approach to determine their fair value should be current replacement cost;
  - the draft illustrative examples in the ED appropriately reflect the decisions by the Board in April to provide support on the application of AASB 13 to: (i) paragraph 28(b) regarding legally permissible uses of an asset; and (ii) paragraphs B8 and B9 regarding the cost approach; and
  - public-sector-specific guidance on AASB 13 should be added to the draft ED on other practice issues discussed in paragraphs 12–14 of this paper; and, if so, the principles to be set out in that guidance.

## Reasons for bringing the draft ED to the Board at this meeting

2. The Board instructed Staff to commence work on drafting the ED for the issues decided by the Board at the April 2019 meeting. Additionally, the Board instructed Staff to include, in the draft ED, Staff's recommended guidance to address additional practical issues that have yet to be considered by the Board.

3. In this meeting, Staff ask the Board to consider a working draft of the ED and make decisions on the drafting of the proposed amendments and illustrative examples to be set out in the ED.
4. Staff also request Board members to consider the proposed project timeline outlined in paragraph 15 below.

### **Attachment**

Agenda Paper 6.2 Working draft of Exposure Draft *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-cash-generating Assets of Not-for-Profit Public Sector Entities*

### **Background**

5. In 2017 eight specific topic areas were identified by the Fair Value Measurement Project Advisory Panel (the Panel) as needing public-sector-specific guidance, and agreed by the Board, to be included in this Project. They are:
  - Topic 1 – Restrictions on assets;
  - Topic 2 – “Highest and best use” concept;
  - Topic 3 – When to use the different valuation approaches;
  - Topic 4 – Implementation guidance for current replacement cost (CRC);
  - Topic 5 – Obsolescence;
  - Topic 6 – Disclosure relief;
  - Topic 7 – Interaction of AASB 13 with other Standards; and
  - Topic 8 – Repurchased internally generated intangible assets.
6. At the April 2019 Board meeting, the Board decided to issue an Exposure Draft of proposed guidance, to address Topics 1–5, that would support AASB 13 for application by not-for-profit public sector entities.

### **Overview of the working draft ED**

7. Staff have drafted the proposed amendments to AASB 13, implementation guidance, illustrative examples and basis for conclusions based on the staff recommendations in addressing the following:
  - the three issues relating to Topics 1, 2, 3 and 5 that were discussed by the Board at its April 2019 meeting. The Board’s decisions on these issues and references to the draft ED are included in paragraph 10 below; and
  - three other practice issues, relating to Topics 3 and 4, to be discussed with the Board at this meeting. Paragraphs 11–14 below provide a high-level summary of the issues and views analysed by Staff.
8. The Basis for Conclusions reflects the different viewpoints discussed with stakeholders about the 6 issues. The draft “Board’s observations” and “Board’s conclusions”

expressed in the Basis for Conclusions reflect the Staff’s view and recommendation on each issue.

### Questions to the Board

9. Staff have included a number of specific questions for the Board as comment boxes in the working draft ED. As such, there are no questions to the Board in this cover memo, other than the questions related to the proposed timeline in paragraph 15 below.

### The Board’s decisions in April 2019 meeting

10. The following table outlines the Board’s decisions in addressing the three practical issues discussed at the April 2019 meeting and references to the draft ED showing how the Board’s decisions have been reflected in the draft guidance.

Issue	Board’s decisions	Reference in draft ED
<p>Issue 1: relates to Topics 1–3</p> <p>Appropriate valuation approach – specialised assets and assets with restrictions</p>	<p>Specify in AASB 13 that, for assets not held primarily for their ability to generate net cash inflows, the approach to determine their fair value should be current replacement cost.</p>	<p>Paragraphs Aus66.1, IE2 and BC4-BC24</p>
<p>Issue 2: relates to Topic 1</p> <p>Treatment of restrictions at different levels of a consolidated entity</p>	<p>Include an illustrative example in AASB 13 to clarify that, if a government (parent entity) can rescind a law or regulation restricting the use (or pricing of the use of) an asset without parliamentary approval, the restriction should be treated as non-legally binding at the parent entity level.</p> <p>At the parent entity level, the asset’s fair value should reflect the present existence of the restriction but also the parent’s option to rescind the restriction.</p>	<p>Paragraph IE3 and BC28–BC35</p>

Issue	Board's decisions	Reference in draft ED
<p>Issue 3: relates to Topic 5</p> <p>Obsolescence – Trigger for economic obsolescence</p>	<p>Include an illustrative example in AASB 13 to clarify that when measuring an asset's fair value at its current replacement cost, economic obsolescence should not:</p> <ul style="list-style-type: none"> <li>(i) be identified if the asset has apparent 'excess capacity' that is temporary or occurs cyclically; and</li> <li>(ii) be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity.</li> </ul>	<p>Paragraph IE5 and BC44–BC47</p>

### **Additional practice issues and Staff's recommended guidance**

11. Staff have assessed three additional practice issues and included detailed analysis in the Basis for Conclusions section of the draft ED. A high-level summary of the different viewpoints discussed with stakeholders on each of the three issues has been included below for the Board's information.

#### ***Issue 4: Nature of component costs to include in an asset's current replacement cost (CRC) [relates to Topic 4, refer Example 3 and BC36–BC43 in draft ED]***

12. Some constituents, and a majority of Project Advisory Panel members, requested the Board to clarify which costs should be included in the CRC of a self-constructed asset. (Note that Issue 5 below discusses borrowing costs and other finance costs.)

There are currently three views being debated with practitioners:

- View 1 – the CRC of a self-constructed asset should be estimated by assuming that the asset does not presently exist and needs to be replaced from scratch; and therefore should include estimates of current replacement cost on the conditions that existed when the asset was initially constructed. Costs of repairing damage to other facilities should not be included in the CRC if those facilities did not exist when the asset was initially constructed (refer BC37 in draft ED).
- View 2 – the CRC of a self-constructed asset should exclude any components of the asset that will not require replacement in the future because their service potential does not expire over time (refer BC38 in draft ED).
- View 3 (which is also Staff's view) – the CRC of a self-constructed asset should include estimates of current replacement cost on the assumption that the asset does not presently exist, and should reflect the conditions existing at the measurement date. It includes the costs of repairing damage to other facilities if those facilities exist at the measurement date (refer BC40–BC43 in draft ED).

**Issue 5: Whether the current replacement cost of a self-constructed asset should include borrowing costs [relates to Topic 4, refer BC57–BC66 in draft ED]**

13. Some constituents, and a majority of Panel members, requested the Board 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.

There are currently two views in practice:

- View 1 – a not-for-profit public sector entity should be required to 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 (refer BC60–BC61 in draft ED).
- View 2 – borrowing costs should always be included in the current replacement cost of a self-constructed asset held by a not-for-profit public sector entity (refer BC62–BC65 in draft ED).

Staff noted that the treatment of borrowing costs and other finance costs when measuring the fair value of a self-constructed asset using the current replacement cost approach is not specific to not-for-profit entities in the public or private sector. Therefore, to avoid inadvertently implying how for-profit entities should treat these costs in the absence of explicit guidance in AASB 13, Staff do not recommend specifying the treatment of those costs for fair value measurements by not-for-profit public sector entities.

**Issue 6: Whether the fair value of the land component of a non-cash-generating real property should always be measured in the land's present location [relates to Topic 3, refer Examples 6A and 6B and BC47–BC56 in draft ED]**

14. Some constituents, and a majority of Panel members, requested the Board to clarify whether the land component of a real property not held primarily to generate net cash inflows should always be measured in the land's present location. For example, if a facility could deliver its services equally well in a nearby location with cheaper property, should the fair value of the land reflect the price of the property in the cheaper location?

Three views were identified:

- View 1– apply the principle that an asset's CRC is measured on an optimised basis by reference to the price of a modern equivalent asset adjusted for differences in service capacity. The property's market value estimate should reflect the price of suitable property in a cheaper feasible location if it exists (refer BC49-BC50 in draft ED).
- View 2 – the fair value of real property should always reflect the property's current location (refer BC51 in draft ED).
- View 3 (which is also Staff's view) – it will depend on facts and circumstances whether the fair value of real property should reflect the property's current location. The answer will depend on the assumptions made by the market

participant buyer regarding the location that would generate the highest returns, when there is a feasible alternative location for a property providing the same services (refer BC52–BC56 in draft ED).

### Proposed project timeline

15. The following table contains a proposed project timeline for the Board’s consideration and comment. The milestones and timeline will periodically be reviewed and updated to ensure the project path remains appropriate and the project can be adequately resourced.

Meeting / Deliverable	Project Milestones
<b>1 June – 5 July 2019</b>	<p>Staff to undertake the following tasks and discuss findings with the Panel:</p> <ul style="list-style-type: none"> <li>• analyse issues on fair value measurement of lessees’ right-of-use (ROU) assets and prepare recommended guidance (relates to Topic 7) ;</li> <li>• analyse other issues raised by individual Panel members (including Topic 6 and Topic 8), which are in addition to the eight topic areas approved by the Board, and consider whether there is a need to develop guidance on these additional issues; and</li> <li>• summarise guidance from other jurisdictions (eg NZASB, IPSASB, UK) on the issues considered in the ED and document the reasons why AASB’s draft guidance differs from these jurisdictions (if that is the case).</li> </ul>
<b>19 July 2019</b>	Panel meeting – present analysis of the above issues to the Panel for feedback.
<b>22 July – 3 September</b>	Staff to update draft ED addressing the issues discussed in the April and June 2019 Board meetings and incorporate feedback from the Panel on the additional issues and prepare Board papers for September 2019 Board meeting.
<b>17 September 2019:</b> Board meeting	<p>Present analysis of fair value measurement issue regarding ROU assets and other issues raised by individual Panel members for the Board to determine whether the guidance should be provided in the form of illustrative examples in the ED or whether FAQs would suffice.</p> <p>Board to consider draft ED and decide on the guidance to be set out in the ED.</p>

Meeting / Deliverable	Project Milestones
<b>18 September – 2 October 2019</b>	Staff to update draft ED based on decisions made in the September Board meeting.
<b>2 – 16 October 2019</b>	Circulate ballot draft of ED for Board (or sub-committee of Board) to vote out of session on 2 October 2019. Propose 2 weeks to vote until 16 October 2019.
<b>17 October 2019 – 31 January 2020</b>	Issue ED on 17 October 2019 for public comment for a period of 106 days (slightly longer comment period due to public holidays in December and January). Comment period ends 31 January 2020.
<b>October 2019 – January 2020</b>	<p>Staff to undertake the following tasks:</p> <ul style="list-style-type: none"> <li>• conduct outreach to stakeholders regarding the ED;</li> <li>• Panel meeting – present the ED to the Panel for feedback; and</li> <li>• develop FAQs on ROU assets and other fair value measurement issues (if the Board proceeds with this option) and circulate to panel members and other key stakeholders for feedback .</li> </ul>
<b>February 2020</b>	Staff to collate comments from submissions on ED.
<b>February 2020:</b> Board meeting	<p>Staff to provide verbal update to the Board on feedback/comments received on the ED.</p> <p>(Depending on the timing of Board meetings in 2020, Staff might not have sufficient time to consider all comment letters received on the ED before the February Board meeting.)</p>
<b>*March 2020</b>	<p>Panel meeting (if needed) – to discuss any additional examples or guidance drafted by Staff.</p> <p>Staff to draft Board papers and draft Amending Standard reflecting Staff recommendations on how to address constituent comments, which could include changes to examples/guidance in ED and/or drafting more examples/guidance supporting AASB 13.</p>
<b>*April 2020:</b> Board meeting	Board to consider draft Standard, comments from submissions on ED and comments from Panel members.
<b>*April – May 2020</b>	Staff to update draft Standard based on decisions made in April 2020 meeting – this will be drafted as a ‘Fatal Flaw’ Draft Standard.
<b>*May 2020</b>	Circulate Fatal Flaw draft Standard to Board members out of session for voting based on decisions made in April 2020 meeting (if Board decides to issue a Fatal Flaw).

Meeting / Deliverable	Project Milestones
<b>*May – June 2020</b>	Issue Fatal Flaw draft Standard for public comment with a comment period of 30 days (if Board proceeds with this option) and circulate to Panel members for comment.
<b>*July 2020</b>	Collate comments on Fatal Flaw draft Standard, prepare Staff paper, and update draft Standard with Staff recommendations on how to address constituent comments.
<b>*July 2020</b>	Board to consider Staff paper and comments on Fatal Flaw draft Standard out of session and vote on ballot draft Standard updated for those comments.
<b>*July 2020</b>	Issue final Standard

\*Note: the timeline will change if the Board decides to make significant changes to the proposals in the ED as a result of feedback received and as part of the due process, the Board needs to expose those revisions.

**Question for Board members**

Do Board members agree with the proposed project milestones and timeline?