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Australian Property Institute Ltd. ACN 608 309 128

30 June 2022

Request for Comment on AASB Exposure Draft - ED 320 Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

Prepared by the Specialist Government and Statutory Assets Working Group,
a subcommittee of the API Standards Steering Committee

The API would like to thank all the members of the Specialist Government and Statutory Assets Working Group for their contributions, knowledge and insights which formed the basis of the APIs responses and comments.

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Yours faithfully,

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The API through the work of the Standards Steering Committee and specialist working groups provides the following response to the AASB Exposure Draft – ED 320 Fair Value Measurement of Non-Financial Assets of not-for-Profit Public Sector Entities.

Scope

1 Do you consider that the proposed authoritative implementation guidance should be applicable also to NFP entities in the private sector?

Please provide reasons to support your view.

Response:

The API provides no comment to question 1.

Reasons:

This is a decision for the AASB and their consultation with entities in the not-for-profit public sector.

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2 Do you agree with the AASB's conclusion that determining appropriate measurement techniques for measuring the fair value of land and improvements on land subject to public-sector-specific legal restrictions is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards (see paragraphs BC164–BC170)?

Please provide reasons to support your view.

Response:

The API agrees that the Australian Accounting Standards should not be mandating valuation standards/methodologies.

Reasons:

The API consider there should be no mandate for AASB to provide guidance to Valuers on valuation standards/methodology. Guidance should be left to the Valuer to interpret the AASB Standard in line with International Valuation Standards and relevant State Treasury Policy.

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Market participant assumptions

3 In respect of the assumptions used in measuring the fair value of a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, do you agree with the proposals in paragraphs F4–F7 that:

(a) if the market selling price of an identical asset is directly observable, that price (which incorporates implicitly the assumptions that other market participants would use when pricing the asset, negating the need to identify those assumptions) should be used to estimate the fair value of the asset; and

(b) if the market selling price of an identical asset is not directly observable, the entity would need to explicitly estimate the pricing assumptions that other market participants would use. In this case, to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:

  (i) if all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity should use those assumptions in measuring the fair value of the asset; or

  (ii) if not all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity would need to develop unobservable inputs in measuring the fair value of the asset. When applying paragraph 89 to develop unobservable inputs, the entity should use its own assumptions as a starting point and adjust those assumptions if reasonably available information indicates that other market participants would use different data; or

  (iii) if no relevant information about other market participant assumptions is reasonably available, the entity should use its own assumptions in measuring the fair value of the asset?

Please provide reasons to support your view.

Response:

(a) The API agrees if identical assets are available for comparison purposes.

(b) (i) API agree – the assessment should maximise observable and minimise unobservable information

  (ii) API agrees in principle. However, in these cases the asset would not be an identical asset where level 1 inputs are observable

  (iii) API agrees in principle. However, in these cases the asset would not be an identical asset where level 1 inputs are observable

Reasons:

The API acknowledges that Level 1 inputs are for identical assets. The assumption of Level 1 inputs is generally for financial assets only and does not apply for non-financial assets. API Valuers would generally be involved in valuing non-current assets (land and buildings) that do not have identical (Level 1) inputs.

- Level 1 inputs – quoted prices in active markets for identical assets. Not generally applicable for valuations of real property assets
- Level 2 inputs – inputs other than quoted prices observable for the asset, either directly or indirectly. Generally, where direct comparison is used with little adjustment to sales.
- Level 3 inputs – unobservable inputs. Generally depreciated replacement cost, discounted cash flows, capitalisation method.

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4 Paragraph F8 provides examples of assets for which:

(a) market selling prices of an identical or a comparable asset are unlikely to be directly observable; and

(b) no relevant information about different assumptions of other market participants is likely to be reasonably available.

Do you agree with the examples in paragraph F8?

Please provide reasons to support your view

Response:

The API agrees.

Reasons:

There is the potential to expand the examples to include other Government assets such as hospitals, schools, court houses, sport stadium, libraries, Government House.

Highest and best use

5 Do you agree with the proposal in paragraphs F9–F11 that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use should be rebutted when, and only when, the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or to use the asset for an alternative purpose?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

A plan to sell surplus assets (land/building) may indicate that the current use is no longer the highest and best use.

The API notes that in certain situations the timeframe to prepare the asset to have it ready for sale may be quite some time down the track; and as such the API does not consider that the highest and best use has changed until the asset is ready for sale in the condition that management intended. This is for the not-for-profit public sector entity to decide and advise the valuer to assess according to the intended use of the asset.

In certain circumstances, an entity's use of a non-financial asset is presumed to be its current highest and best use unless market or other factors indicate that an alternate use by market participants would maximise the value of the asset.

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6 Do you agree with the example in paragraph F10 of steps that might, in some circumstances of a particular entity, need to be completed before the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or use the asset for an alternative purpose, namely:

(a) relevant field studies or a Ministerial briefing on whether there is a market for the asset (and, if so, its likely price) or for the alternative services that the asset could be used to provide.

(b) initial due diligence processes to determine that a sale of the asset or an alternative use of the asset is possible within the current socio-economic environment and would maximise the asset's value; and

(c) development of project milestones and expected timelines to complete the sale or the plan to use the asset for the alternative purpose?

Please provide reasons to support your view

Response:

The API agrees with question 6.

Reasons:

The API note that the existence of above indicators alone should not be taken as management's commitment to sell the asset or use the asset for an alternative purpose. Feasibility studies and due diligence should be completed prior to management's commitment to sell the assets.

However, as noted in our response in question 5, management's commitment to sell the asset is considered too premature and should not be the indicator to when the highest and best use of the asset has changed as there are other market factors that may need to be considered.

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7 Do you agree with the proposal in paragraph F12 that an entity is only required to assess whether a use of the asset is physically possible, legally permissible, and financially feasible in accordance with paragraph 28 when (per paragraph F9) the presumption in AASB 13 paragraph 29 that the asset's current use is its highest and best use is rebutted?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

An entity should only be required to assess whether a use of the asset is physically possible, legally permissible, and financially feasible, when the presumption that the asset's current use is its highest and best use is rebutted. That is, the asset should not have to be assessed based on its current use. This would only occur when the asset is considered surplus and no longer required by the entity, and the requirements under question 6 have been satisfied.

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8 Do you agree with the draft implementation guidance in paragraph F13 for applying the 'financially feasible use' concept described in AASB 13 paragraph 28(c), namely that, for a non-financial asset of an NFP public sector entity not held primarily for its ability to generate net cash inflows, a use is financially feasible if market participants (including NFP public sector entities) would be willing to invest in the asset's service capacity, considering both the asset's ability to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

A use would be financially feasible if other market participants would be willing to invest in the asset, that is, other not-for-profit public sector entities must be considered as market participants.

Application of the cost approach

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

9 Do you agree with the proposal in paragraph F14(a) that the entity should assume the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location?

Response:

The API agrees.

Reasons:

The asset should be assumed to be replaced in its existing location.

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10 Do you agree with the proposal in paragraph F14(b) that the entity should assume that the asset subject to measurement (the subject asset) presently does not exist; and therefore, all necessary costs intrinsically linked to acquiring or constructing the subject asset at the measurement date should be included in the asset's current replacement cost?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

Any cost that is directly attributable to the acquiring or constructing the asset should be considered and included in the assessment. This is consistent with the requirements of AASB 116 *Property, Plant and Equipment* (paragraphs 16 and 17) and should form part of the current replacement cost.

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11 Do you agree with the proposal in paragraphs F14(b) and F14(c) that, when estimating the current replacement cost of the subject asset, the entity should estimate the replacement cost of a reference asset (i.e., a modern equivalent asset or a replica asset) as input and adjust the estimated replacement cost of a reference asset for any differences between the current service capacity of the reference asset and the subject asset?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

This is applicable to heritage buildings held because of their heritage significance. The current cost is the cost of replicating the existing asset. This is because the replication cost reflects the heritage value or quality embodied in the asset.

Replication (reproduction cost) would assume reconstruction with modern materials, but sympathetic with the original heritage design and structure, to the extent that this is feasible. If a heritage building was constructed with an imposing entry, high ceilings, elaborate sandstone carvings, open verandas and large carved cedar doors, the cost of replication would reflect that design and structure.

IVS 105 *Valuation Approaches and Methods* at paragraph 70.6 and 70.7 provides guidance to Valuers regarding the reproduction cost method. In the normal course of providing professional services, a Valuer would seek further expert advice/guidance from Quantity Surveyors, Construction handbooks and actual construction costs provided by the entity.

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12 Do you agree with the proposal in paragraph F15(a) that once-only costs that would be expected to be necessarily incurred in a hypothetical acquisition or construction of the subject asset should be included in that asset's current replacement cost? Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

F15(a) refers to a hypothetical subdivision and AASB-13 refers to exit price. Consistency in the approach taken, will be important when considering acquisition costs for an exit price assessment. (AASB 13, paragraphs 24 and 57 refer to 'exit price').

> *"(24) Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.*
>
> *(57) When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability is the price that would be*

received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them."

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13 Do you agree with the proposal in paragraph F15(b) that, when estimating the current replacement cost of the subject asset, an entity should determine, based on the circumstances of the subject asset, whether the following costs would (among other costs) need to be incurred upon the hypothetical acquisition or construction of that asset at the measurement date:

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

(b) any disruption costs that would hypothetically be incurred, when acquiring or constructing the subject asset at the measurement date, including costs of restoring an asset not controlled by the consolidated group (if any) to which the entity belongs?

Please provide reasons to support your view.

Response:

The API agrees but consider that consistency is important in applying acquisition costs to an exit price assessment.

Reasons:

Our understanding of F 15(b) is:

(i) the demolition cost of buildings to achieve a vacant land asset.

(ii) redirecting infrastructure works such as removing power or water infrastructure from land required for a main roads acquisition.

Note: The demolition costs may be considered as part of the acquisition costs for achieving a vacant land equivalent, in other circumstances if an existing building is demolished it would be up to the entity to determine to how to account for the demolition and any disruption costs.

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14 Do you agree with the proposal in paragraph F15(c) that an NFP public sector entity includes in the subject asset's current replacement cost all necessary costs required to be incurred in the context of the entity's expected manner of replacement in the ordinary course of operations, rather than necessarily including only the cheapest legally permitted costs to the entity?

Please provide reasons to support your view.

Please note that Illustrative Examples 1 and 2 illustrate the application of paragraphs F14 and F15

Response:

The API agrees.

Reasons:

The actual cost needs to be reflected not at a lower cost. That is apply the extra cost of works during construction if applicable.

API acknowledges BC126 which notes

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

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15 Do you agree with the proposal in paragraph F16 that identifying economic obsolescence should not be limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

The International Valuation Standards at IVS 105 *Valuation Approaches and Methods* paragraph 80.7 states;

> "Economic obsolescence *may* arise when external factors affect an individual *asset,* or all the *assets* employed in a business and *should* be deducted after physical deterioration and functional obsolescence. For real estate, examples of economic obsolescence include:
>
> (a) adverse changes to demand for the products or services produced by the *asset,*
>
> (b) oversupply in the market for the *asset,*
>
> (c) a disruption or loss of a supply of labour or raw material, or
>
> (d) the *asset* being used by a business that cannot afford to pay a market rent for the *assets* and still generate a market rate of return."

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16 Do you agree with the proposal in paragraph F17 and the example in paragraph F18 that economic obsolescence should not be identified for any 'surplus capacity' of an asset that is necessary for stand-by or safety purposes (e.g., to deal with contingencies), even if it seldom or never is actively utilised?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

As noted previously in response to question 15 the International Valuation Standards at IVS 105 *Valuation Approaches and Methods* paragraph 80.7 states;

> "Economic obsolescence *may* arise when external factors affect an individual *asset,* or all the *assets* employed in a business and *should* be deducted after physical deterioration and functional obsolescence. For real estate, examples of economic obsolescence include:
>
> (a) adverse changes to demand for the products or services produced by the *asset,*
>
> (b) oversupply in the market for the *asset,*
>
> (c) a disruption or loss of a supply of labour or raw material, or
>
> (d) the *asset* being used by a business that cannot afford to pay a market rent for the *assets* and still generate a market rate of return."

The assessment of 'surplus capacity' (required for standby or safety purposes due to changing demographics) such as a school building, which may be assessed as a change of use and is not recognised as surplus capacity.

Application of the proposed implementation guidance

17 Do you agree with the proposal in paragraph AusC6.1 that the proposed authoritative implementation guidance set out in Appendix F should be applied prospectively?

Please provide reasons to support your view.

Response:

The API offers no response to this question.

Reasons:

It does not apply for API real property Valuers.

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18 If you agree with prospective application in Question 17, do you consider that it would be appropriate for the AASB to provide an option for an NFP public sector entity to elect to restate comparative information as if the authoritative implementation guidance in Appendix F had been applied from a preceding period?

Please provide reasons to support your view.

Response:

The API offers no response to this question.

Reasons:

It does not apply for API real property Valuers.

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19 If you consider it appropriate for the AASB to provide an option for an NFP public sector entity to restate comparative information (see Question 18), do you consider it appropriate that, if an entity elects to restate comparative information, it should be required to disclose the amount of the adjustment for each financial statement line item affected, as if the implementation guidance had:

(a) always been applied (i.e., full retrospective application in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors); or

(b) been applied from a specific preceding period, for example, the beginning of the immediately preceding period presented in the financial statements (i.e., modified retrospective application)? If so, please specify which preceding period you think would be appropriate.

Please provide reasons to support your view.

Response:

The API offers no response to this question.

Reasons:

It does not apply for API real property Valuers.

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20 Further to Question 19, do you consider it would be appropriate for such optional restatements, if elected, to be required for all affected assets, except to the extent it is impracticable for the entity to determine either the period-specific effects of the implementation guidance or the cumulative effect of the change?

Please provide reasons to support your view.

Response:

The API offers no response to this question.

Reasons:

It does not apply for API real property Valuers.

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21 Do you agree that the proposed authoritative implementation guidance set out in Appendix F should be applied for annual periods beginning on or after 1 January 2024, with earlier application permitted?

Please provide reasons to support your view.

Response:

The API agrees.

Reasons:

General matters for comment

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

22 Whether the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft?

Response:

The API offers no response to this question.

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23 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?

Response:

The API offers no response to this question.

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

Response:

The API offers no response to this question.

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

Response:

The API offers no response to this question.

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

Response:

The API offers no response to this question.

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

Response:

The API is unable to provide any further response to this question.
