Comments on ED320

This is a great initiative, with respect to providing guidance to NFP organisations on how to measure the Fair Value of non-financial assets to ensure compliance with AASB13.

Given that the period has lapsed in providing feedback (I only recently came across this Exposure Draft), my comments relate directly to the Application of the Cost Approach, as this is the area that in my opinion requires most guidance.

Without authoritative implementation guidance and/or examples, many NFP entities, valuers and auditors are often left to their own interpretation of the standards when undertaking revaluations. As a result, the financials reported in each NFP entities General Purpose Financial Statements may not be comparable due to the varied assumptions and inputs.

Thank you for the opportunity to provide feedback into this very important initiative and update to the accounting standard AASB13.

Regards

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MEM, MIEAust

Comments on ED320 – Application of the cost approach – Questions 9-14

Q9. 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? Please provide reasons to support your view

Agree with the intent. The Fair Value measurement is a snapshot in time of the asset. The current state of Asset Management Plans in the industry are based on the assets providing services into perpetuity. Hence assets should be valued in accordance with their current service provided, in order to provide a true representation of the assets cost and subsequent Fair Value.

Q10. 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.

Agree with the intent, however, in my opinion, this clause should be reviewed. Using infrastructure non-current assets as an example, the clause could again be open to interpretation with regards to the assumptions/inputs as to the site details in terms of where assets are constructed and/or some costs can often be attributed to more than one asset due to construction practices.

Also bringing all costs to account in some cases may require relocating many other assets or services - in very unique cases like relocating an entire town to build a dam or a freeway through a township or rationalising a number of facilities into precinct hubs.

A suggestion to improve this clause is:

The entity must include all necessary costs that would be required to currently replace the existing “service capacity” of an asset, when there are no market participants. Careful consideration of costs are required to ensure that costs are not duplicated between assets.

For example, when considering the cost to replace an existing pipe asset within a roadway, whilst in reality an organisation would excavate and be required to reinstate the road pavement and surface and/or may have to move services controlled by other authorities, these costs must be excluded as they are accounted for either within the road asset and/or by other authorities.

Q11. 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.

Agree with the intent.

Could the definition clarify that the modern equivalent asset intention is applicable in cases where an existing asset cannot be sourced or replaced with current existing design standards, materials, practices and/or technology? Some suggested text to clarify as follows:

- All existing assets will be renewed in accordance with current industry design standards and replaced like for like, where possible; or
- In cases where assets are not able to be renewed like for like (due to changed design standards, materials, practices and/or technology), the gross replacement cost of the asset will be assessed based on replacement with a new asset having similar service potential (modern engineering equivalent).

Some examples:

- For example, a 5kw pump by company AB cannot be applied a replacement cost equivalent to a 10kw pump by company AB, however, can be applied a replacement cost equivalent to a 5kw pump by company XY (modern engineering equivalent), if company AB no longer manufacture 5kw pumps.
- A 200mm diameter asbestos cement pipe can be applied a replacement cost equivalent to that of a 200mm diameter reinforced concrete pipe (depending on an organisations adopted engineering standards), as asbestos cement pipes are no longer manufactured. This is considered a modern engineering equivalent.

Q12. 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.

Agree with the intent.

Would suggest that where this is the case, that such costs are assigned to a separate component and depreciated separately, to ensure that the annual depreciation is not misstated.

Q13. 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.

Agree with the intent. As it reflects the assets true fair value.

Q14. 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.

Agree with the intent, however, believe there is an opportunity to provide much clearer definitions in this clause in terms of what costs should be considered by an entity when determining the replacement cost. Maybe providing a list of acceptable inputs when developing unit rates as per the following would be beneficial in an appendix:

- Strategic planning reports
- Project scoping and investigation and planning approvals
- Demolition
- Disposal
- Traffic management
- Survey and design
- Professional fees
- Site preparation and establishment
- Construction
- Contract payments
- Construction direct costs such as wages, salary, plant & equipment, materials and on-costs
- Overheads
- Supervision
- Transport, installation, assembly and testing
- Project management

The current contentious issue currently when determining an assets Fair Value, is the acceptance by some NFP entities and auditors (depending on the State) of acceptable cost inputs pertaining to the demolition and disposal of the existing asset in order to replace it. Other costs such as designs, planning, professional fees etc are widely and typically accepted when determining an assets Fair Value.

The true current replacement cost of an asset should include all reasonable costs and these include the costs required to demolish and dispose of the existing asset, in its current location and environment.

Other issues include the sourcing and use of contractually cheapest costs which can be based on schedule of rates that may be flawed as the contracts may be biased on some parts versus others eg asphalt rates based on regional volumes or a larger construction contract with an efficient rate for footpath construction or a small rehabilitation project with low volume kerb has a very high unit rate.

Again, an opportunity here would be to reinforce the fact that asset current replacement costs, ensure that they exclude duplication of costs between assets where these are interrelated as a result of design i.e. roads, pipes, kerbs, service conduits and that appropriate rates sourced which reflect the quantum of work and availability of resources.