Contact: *Steve Mitsas*
Email: steve.mitsas@dtf.vic.gov.au

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
VIC 8007 Australia

Dear Dr Kendall

ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* (ED 320). HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises senior accounting policy representatives from all Australian states and territories and the Australian Government.

At the outset, HoTARAC would like to thank the Board and its staff for their considerable effort in bringing together the key stakeholders across the public sector to dialogue and understand the key public sector challenges and perspectives related to the implementation of fair value reporting for non-current assets. We particularly appreciate the constructive and engaging consultation approach taken by the Board before finalising the ED.

Overall, HoTARAC is highly supportive of the ED and considers it provides highly useful additional implementation guidance for application by not-for-profit (NFP) public sector entities which will facilitate greater consistency in the assumptions and components included in fair value reporting.

Having said that, we would like to note the different requirements in AASB 116 *Property, Plant and Equipment*, AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* and AASB 13 *Fair Value Measurement* and propose that the AASB prioritise a review for alignment to ensure consistency in the approach for capitalisation and fair value measurement. Adopting different methodologies/approaches/components across the individual accounting standards have caused significant differences between initial measurement at cost in the first year and the measurement of fair value using revaluation model in subsequent years.

The attachment to this letter sets out HoTARAC's response to the specific and general matters for comment.

If you have any queries regarding HoTARAC's comments, please contact Steve Mitsas from the Department of Treasury and Finance in Victoria by email to steve.mitsas@dtf.vic.gov.au.

Yours sincerely

Stewart Walters

CHAIR

Heads of Treasuries Accounting and Reporting Advisory Committee

ENCLOSED:

HoTARAC Comments to the AASB on 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.

No comments

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.

Agree

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

Agree.

(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.

Agree.

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

Agree.

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.

Disagree.

While we agree that this seems to reflect the requirements of AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* that when an asset has been flagged as 'ready for sale' and potential buyers have been identified, the valuation method should change to reflect the new highest and best use of the assets. However, we note that the current wording suggests that the point of recognition of the new and highest best use, is when management is committed to make a change, rather than when the asset is ready for sale. We note that sales of government assets frequently have an extended lead time and are subject to legislative and regulatory steps. Such sales are generally subject to a confidential tender process, and any early disclosure may risk potential information leakage. We do not believe that the highest and best use has changed until the asset is ready for sale in the condition that management intended. We recommend amending the threshold to align with conditions set out in AASB 5 ,for consistency.

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

Agree.

We note that the existence of the above indicators alone should not be taken as management commitment. Feasibility studies and due diligence should be completed prior to management's commitment to sell the assets. However, as noted in our response to 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. We propose alignment to the conditions sets out in AASB 5 before the change in the highest and best use should be reflected.

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.

Agree.

However, we note that for public-sector-specific legal restrictions on prices that can be charged (BC69-70), ED320 states that "legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset not held primarily for its ability to generate net cash inflows that would not be transferred to market participants are not considered in fair value measurement of the asset". This may have unintended consequences for the valuation of dual-purpose assets, i.e. assets which can theoretically be used by both public and private sectors, such as hospitals. We recommend further clarification is provided.

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.

Agree.

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?

Agree.

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.

Agree.

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

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.

Agree, except for heritage and cultural assets. Given the unique and specialised nature of heritage and cultural assets, it will not be possible to adopt a modern equivalent or replica asset, as the replacement cost will need to follow the specific requirements to restore such assets.

Further, some members are of the view that for heritage buildings held, at least some in part, because of their heritage significance, current cost means the cost of replicating the existing asset. This is because the replication cost reflects the valuation of 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. For example, if a heritage building was a prestige construction 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.

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.

Agree.

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.

Agree.

All unavoidable costs of removal and disposal of unwanted existing structures on land should be included in the current replacement cost of the asset as a part of the land cost. However, some HoTARAC members would like the Board to clarify when these costs should form part of fair value of the structure to be built on the land, and when they should form part of fair value of the land (ED320 BC99-106 and Illustrative example 1).

Based on the example provided in paragraph BC100, to assess the inclusion of the costs of removal and disposal of unwanted existing structures of land, an entity would consider whether a market participant buyer would be able to acquire a vacant site in the area surrounding the existing location. Where there is a suitable vacant site available, the market participant is unlikely to incur removal and disposal costs, otherwise, the removal and disposal costs should be included in the current replacement cost of the asset. Some HoTARAC members are of the view that that it will be challenging to make assumptions on what structures on the existing location will be required to be removed or demolished. Consequently, it may be difficult to justify the inclusion or exclusion of these costs in the fair value and how they are valued.

Some members are of the view that including the costs of removal and disposal of any unwanted existing structures on land as per paragraph F15(b)(i) contradicts with paragraph F14. As per paragraph F14(a), the asset will be replaced in its existing location even if it would be feasible to replace the asset in a cheaper location. In essence, the asset should be replaced on the vacant land as paragraph F14(b) assumes the asset does not exist, therefore making 'removal / disposal' costs irrelevant. Further, the members raise concerns on the cost/benefit impact of including any disruption costs that would hypothetically be incurred, according to paragraph F15(b)(ii). The uniqueness of the disruption cost of individual assets will require revaluation of each asset of the portfolio, which could be costly.

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

Agree.

One issue of particular concern to HoTARAC is the treatment of funding costs when determining values using replacement cost. There are different views across HoTARAC about the treatment of funding costs in asset valuation. This is likely due to different perceptions and experiences about the costs that a market participant would consider in determining exchange value.

In turn, a key determinant might be <u>the entity's expected delivery model and how assets will be replaced, because this could determine the relevant market from which market participant assumptions should be drawn.</u> For example, depending on the delivery model, a market participant (i.e., a public sector not-for-profit entity) may incur funding costs in relation to an asset construction through either a centralised funding agency or private sector financing arrangement (e.g., a PPP consortium finances the upfront construction cost of an asset and on-charges its funding costs to the Government). As public funds (whether borrowed or not) are distributed through different channels to fund various public sector projects, costs of the debt raising in a centralised funding arrangement may bear little connection with an individual asset construction. As such, it would be unlikely that a market participant will identify and price-in such funding cost when valuing an infrastructure asset. However, in some PPP models, the practice is that the private sector entity will incur funding costs while constructing the asset and will factor this into the contract price in a way that it becomes a market assumption.

While diverse arrangements make it challenging to mandate inclusion or exclusion of funding costs in every circumstance, we strongly advocate the amendments include guidance to provide greater clarity about application factors that could be considered.

Economic obsolescence

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.

Agree.

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.

Agree.

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.

Agree.

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.

Agree.

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.

(b). modified retrospective application.

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.

Agree.

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.

Agree.

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?

Agree.

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?

We note that the Australian Bureau of Statistics is planning to make a separate submission to the AASB on this ED for consideration and support alignment wherever possible.

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

Agree, subject to the recommendations HoTARAC has made in this submission.

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

Agree, subject to the recommendations HoTARAC has made in this submission.

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

We expect that there may be auditing, and assurance concerns due to the interpretation and application of valuation principles and techniques used which may vary due to the judgement involved.

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.

Please refer to the above responses.