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

Dear Dr Kendall

Ernst & Young is pleased to comment on the above Exposure Draft. We welcome the opportunity to contribute to the future of financial reporting in Australia.

We consider that the AASB should provide specific guidance to enable entities to determine appropriate measurement techniques, including which valuation approach to use, for measuring the fair value of assets not held primarily for their ability to generate net cash inflows. We do not believe that the current proposals in ED 320 go far enough to help reduce diversity in practice in this area.

Please refer to our detailed responses on the above and other questions raised in the ED in the appendix to this letter.

We would be pleased to discuss our comments further with either yourself or members of your staff. If you wish to do so, please contact Frank Palmer on (02) 9248 5555 or Kalaselvi Kandiah on (03) 9288 8034.

Yours sincerely

Ernst + Young

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Appendix A

Responses to Specific matters for comment

Scope

Response to Q1:

We consider that the issues addressed in the proposed guidance could also be relevant to NFP private sector entities. The AASB could conduct more research to understand if there are any specific fair value measurement issues affecting NFP private sector entities and address them in this guidance, if any, before making the guidance applicable to NFP private sector entities. As most NFP private sector entities subsequently measure their non-financial assets, such as property, plant and equipment at historical carrying amounts rather than at fair value (unlike most NFP public sector entities as mentioned in BC2 of this ED), it is likely that NFP private sector entities may not have implementation issues related to AASB 13 to the same extent as the NFP public sector.

Response to Q2:

We do not agree with the AASB's proposals. We consider that the AASB should provide specific guidance to enable entities to determine appropriate measurement techniques for measuring the fair value of assets not held primarily for their ability to generate net cash inflows including the fair value of land and improvements on land subject to public-sector-specific legal restrictions.

As acknowledged in this ED, there is diversity in valuing these types of assets, specifically in the approach used to fair value these assets. There also appears to be significant ambiguity in the manner in which the quantum of discount is applied when fair valuing these assets using the market approach. We also understand that there is uncertainty amongst the public sector for how to deal with restrictions imposed on these assets including those that are self-imposed. We don't think the AASB's proposals go far enough to address these concerns

We understand that providing guidance on how to determine the quantum of discount to apply when valuing these assets using the market approach might prove difficult, particularly as any discounting needs to factor in the nature of the restrictions in place as well as the benefits derived from using the asset for public service. Given the difficulty and subjectivity involved in providing guidance on discounting and including service capacity when applying the market approach to these types of assets, we believe the more objective guidance would be to require NFP public sector entities to fair value non-financial assets not held primarily for their ability to generate net cash inflows using a cost approach (example current replacement cost) if there are no identical or comparable assets with market price available for the asset in its current use.

Requiring the use of the cost approach would be consistent with the requirement in AASB 1059 to measure the fair value of a service concession asset that the grantor uses for its service potential to achieve public service objectives (rather than to generate net cash inflows) using the cost approach. The Board concluded (as in BC66 of AASB 1059) that only the cost approach to measure the fair value of the service concession asset was appropriate as the asset's capacity or service potential is used to achieve public service objectives irrespective of whether the cost of the asset will be recovered by the expected cash flows that the asset may generate. We do not see why the Board could not require a similar approach for other public sector assets that are held for their service capacity or service potential

If the AASB decides to require the use of the cost approach for fair valuing assets not held primarily for their ability to generate net cash inflows including the fair value of land and improvements on land subject to public-sector-specific legal restrictions, we think that the disclosures which are currently excluded for NFP public sector entities, as in paragraph Aus93.1, should be required when using the cost approach.

If the AASB decides not to require the cost approach for measuring the fair value of assets not held primarily for their ability to generate net cash inflows including the fair value of land and improvements on land subject to public-sector-specific legal restrictions (if there are no comparable assets with an observable market price or market information), the AASB should provide guidance on the following when applying the market approach to value these assets:

- how to consider restrictions put in place by the entity or its controlling entity on the asset
- how the likelihood that the restrictions might be lifted should be considered in the valuation
- how to incorporate the benefits obtained by the public due to the public sector service provided by the asset into the valuation
- how to determine the quantum of discount to be applied (if any) on restricted assets including when the service capacity/service potential of the asset has not diminished since acquisition of the asset

Market participant assumptions – Questions 3 and 4

Overall response to Q3 and Q4:

We find the guidance on market participant assumptions (paragraphs F3-F7) does not add anything beyond the existing AASB 13 guidance. As such, we do not consider it necessary to have these paragraphs.

Some of the examples in paragraph F8 (e.g., prisons) may not be relevant as some prisons are owned by private entities. Also, government regularly sells defence weapon platforms and as such these assets would have observable market price/information.

Highest and best use - Questions 5, 6, 7 and 8

We agree with the presumption that the asset's current use is its highest and best use. However, the guidance on when the presumption can be rebutted could go further by having an example that deals with a sale or change in use of the asset, which has several milestones to be met before the sale or change in use can take place because this is prevalent in the public sector.

In addition, the Board should consider whether a commitment to sell the asset is too early to rebut the presumption, given the approval processes required in government before an asset can be sold. Perhaps the presumption should be rebutted only when a formal approval has been made.

We agree with the proposed guidance in paragraph F13 that the use of the asset is financially feasible if market participants (including not-for-profit 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. However, in this circumstance, we question whether there would be an impairment on the asset –on subsequent measurement if its service capacity has not diminished. For example, if a piece of land was acquired at fair value for its service capacity to be converted into a park for public benefit and that service capacity is still intact, then there should not be an impairment on the land on subsequent measurement simply because the land has is now used as park. However, some would argue that since the land is now restricted to be used as a park, there should be a discount applied to the land when fair valuing it on subsequent measurement using the market approach. This appears to contradict the presumption that the land being used as a park is its highest and best use and when it was acquired for this use, it was financially feasible for this use due to its service capacity, which has not changed. We consider that the cost approach would be most appropriate method when fair valuing such assets – see our response to Q2.

Application of the cost approach – Questions 9 – 16

We generally agree with the proposed guidance in the ED (paragraphs F14-F18) on how the cost approach should be applied to measure the fair value of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows.

In addition, when considering the entity's expected manner of replacement in the ordinary course of operations, consideration should be given to the procurement method that would normally be adopted for such an asset by the public sector entity. For example, if it is common to replace a hospital using a service concession approach rather than a design and construct (D&C) approach, then costs related to such a procurement method should be considered in fair valuing the asset under the cost approach and not the potentially cheaper D&C approach.

In respect of finance costs, we note the Board's decision not to mandate a particular treatment for not-for-profit entities applying AASB 13. However, as the purpose of proposals in the ED are to provide guidance, we consider that the Board should bring forward the guidance which is currently in BC130-134 into the final Standard rather than leave it in the BCs.

Application of the proposed implementation guidance – Questions 17 – 21

We agree with the proposal that the guidance should be applied prospectively with early application permitted. We also agree with the application date being for annual periods beginning on or after 1 January 2024, subject to the proposals being finalised and the Standard issued in 2022.

We do not agree to providing 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. Given that the proposals are in relation to measuring fair value, hindsight could be used to estimate the inputs to the measurement, and this would not be appropriate.

Responses to General matters for comment

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

    We do not think that the proposals go far enough to help address the current diversity in practice in fair valuing assets not held primarily for their ability to generate net cash inflows including the fair value of land and improvements on land subject to public-sector-specific legal restriction

23. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?**

    No.

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

    As the current diversity in practice is not adequately addressed, we do not think that the current proposed guidance go far enough to help remove diversity except for the proposed guidance on application of the cost approach.

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

    Refer to our responses above.

26. **Whether the proposals would create any auditing or assurance challenges?**

    Refer to our responses to Q2 and Questions 9 – 16

    The lack of specific guidance in the proposals (as articulated in our response to Q2) to enable entities to determine appropriate measurement techniques, including which measurement approach to use, for measuring the fair value of assets not held primarily for their ability to generate net cash inflows including the fair value of land and improvements on land subject to public-sector-specific legal restrictions, would mean that challenging estimates (eg quantum of discounts and how to incorporate public sector service benefits) would continue to be applied in valuations. In addition, public sector entities are likely to deal with restrictions differently and when using the cost approach, there might be some practical difficulties in estimating some costs when assuming that the asset presently does not exist. This would mean that the current diversity would continue to exist.

27. **Costs and benefits of the requirements relative to current requirements, whether quantitative (financial or non-financial) or qualitative?**

    Refer to our responses above.