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

via submission portal: https://www.aasb.gov.au/current-projects/open-for-comment/

28 June 2022

Dear Keith,

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

I am responding to your invitation to comment on Exposure Draft 320 on behalf of PwC.

We welcome the Board's proposal to address concerns raised by stakeholders in relation to the application of AASB 13 *Fair Value Measurement* (AASB 13) by not-for-profit public sector entities. We agree that many of the concepts in AASB 13 are challenging for not-for-profit public sector entities to apply given the unique nature and purpose of the assets held that are subject to valuation.

While many aspects of the proposals will not result in a change in practice, it is helpful to have clarity in the guidance to encourage consistent application. Overall, we agree with the Board that it is appropriate that the principles of AASB 13 be applied with respect to determining a market participant's perspective of fair value to the extent possible. However, it is challenging to fully apply this concept to public sector assets and thus, we agree with the practical reliefs that the Board has proposed. Specifically, we agree with the proposals with respect to:

- the ability to use own assumptions where market observable pricing for identical assets is not directly observable and relevant information about market participant assumptions is not reasonably available
- considering differences in service capacity and the inclusion of economic obsolescence as proposed
- the rebuttable presumption that current use is the highest and best use (HBU)
- the overarching principle that once only costs be included in current replacement cost ("once only" costs)

However, we consider that certain aspects of the proposals for HBU and once only costs could be refined to ensure they are able to be more consistently and reliably applied. We have also commented below with respect to the application of the proposals to the private sector.

PricewaterhouseCoopers, ABN 52 780 433 757
One International Towers Sydney, Watermans Quay, Barangaroo NSW 2000, GPO BOX 2650 Sydney NSW 2001
T: +61 2 8266 0000, F: +61 2 8266 9999, www.pwc.com.au

1) Highest and Best Use:

In the situation where an asset is considered to be held for sale and the market participant would be able use the asset for a purpose other than delivering public services, we consider that the trigger for recharacterising the highest and best use of an asset should be better aligned to the criteria in AASB 5. These criteria in AASB 5 are well known and understood to preparers and financial statement users. It would be sensible to the users of the accounts to see disclosure and classification of an asset as held for sale at the same time as the fair value remeasurement for a change in the assessment of the asset's HBU. The indicators in paragraph F10 may lead to remeasurement prior to a true commitment being made and the highly probable criteria in AASB 5 being met. In practice, we have seen examples where disposals that may be considered to be committed under the proposals might change year on year. Therefore, the proposals as drafted may lead to additional time and efforts to manage and apply where the information may not be as relevant to the users if the plans were to change.

We do not consider that a change in HBU would occur in a situation where an asset is held for sale and the market participant would continue to use the asset for the same public purpose - i.e. in a privatisation, or a sale of an asset that was then subject to AASB 1059 accounting. Rather, the valuation methodology might be reconsidered.

If the criteria in AASB 5 are introduced, we acknowledge they would not be relevant in the situation where an asset's use or purpose changes for a reason other than sale. In this case, we consider that concepts similar to AASB 5 be provided such as that:

- it is highly probable that the use will change to a specified alternative use
- management of sufficient authority is committed to the plan
- required approvals have been obtained
- actions necessary to transition the asset indicate that it is unlikely that plans with change
- the change in use is expected to be completed within one year

Based on the above criteria, we would expect the remeasurement of the asset to occur prior to any change in classification in asset -- which typically arises when the change in use has occurred (i.e., change from property, plant and equipment to inventory or to investment property).

2) "Once-Only" Costs

Overall, we agree that when current replacement cost methodologies are used to measure fair value, once only costs should be considered. These costs are typically directly attributable costs of bringing the asset to its intended use and thus, we consider it reasonable that the valuation consistently considers that a market participant would have to take similar actions if they were to reconstruct the asset. While we appreciate that the capitalisation criteria in AASB 116 are not intended to be directly aligned to the market participant valuation principles in AASB 13, we do not consider it appropriate that public sector entities have significant impairments on their initial remeasurements where they have efficiently constructed an asset by incurring necessary costs.

However, as the proposals are written, we are concerned that the "starting point" from which once only costs should be identified is not clear - which may lead to increased diversity in practice.

Regarding the guidance within paragraph F14-F15 of the exposure draft, we have considered the different types of possible “once-only” costs and their impacts on different assets as noted below. It may be helpful that further Illustrative Examples are included to ensure greater consistency in application. Specifically:

- **Inherent cost of land**: These costs are related to earth works, remediation, formation work and costs of clearing of the land for construction. We consider that these costs should generally be capitalised into the cost of the land, which is a separate class of asset. Because land is typically valued using market pricing, we would not expect it is needed to further consider these costs. A market participant would be expected to consider land to have more value once these activities are undertaken and thus, they are inherently included in the market participant valuation. As such, where the land has been valued using a market approach, once only costs would typically not need to be further added.

- **Design and engineering costs**: These are clearly costs that a market participant would be required to incur again if they were constructing such an asset. Our understanding is that these costs are typically considered and included in a cost valuation by valuers today, which we would agree is appropriate.

- **Other less visible costs**: There are certain costs that are necessary to be incurred that are less visible to valuers and thus, may not be included in valuations today -- for example:
    - asbestos removal from an existing building
    - relocating power lines or “returned works” assets (i.e., utility assets) that are owned by another entity
    - remediating damage to footpaths/roads
    - constructing assets that are required to be given to a third party
    - demolition costs related to the compulsory acquisition of properties
    - borrowing costs

  While these costs are capitalised as a necessary cost of getting an asset to its intended use, they are not costs that valuers would currently always hypothesize when developing a cost valuation - leading to a possible change in practice. The proposals currently read that once-only costs are included if they would be incurred in a hypothetical construction of the subject asset. However, the “starting point” for determining the hypothetical construction is not clear. For example, should preparers consider the condition of the land and structures as they were when they commenced construction or consider a vacant property (with all of the above works essentially having already been prepared)? We consider the former approach more directly aligns with the conceptual approach of the replacement cost of the asset. However, where an asset was constructed years ago, we expect it would be cost prohibitive for preparers to recreate and maintain the records that are necessary to allow a valuer to provide an estimate of undertaking the same activities in current day dollars. As such, some practical relief may be required.

While companies may categorise their asset classes differently than that noted above, it is important that entities ensure that there is no “double-counting” of value for “once-only” costs if a mix of market and replacement cost valuation techniques are used.

3) Private sector considerations

With respect to the application of the guidance to private sector not-for-profit entities, we would recommend that it be available to them should they wish to adopt. However, further due process may be required should the requirements be made mandatory. Given the current focus of the guidance is public sector entities, we do not expect private not-for-profit organisations have fully considered and responded.

I would welcome the opportunity to discuss our firm's views at your convenience should you have questions.

Yours sincerely,

Erin Craike
Partner