ACT
Government
Chief Minister, Treasury and
Economic Development

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Ms Peach

INVITATION TO COMMENT (ITC) 36 – REQUEST FOR COMMENT ON IASB REQUEST FOR INFORMATION ON POST-IMPLEMENTATION REVIEW — IFRS 13 *FAIR VALUE MEASUREMENT*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on ITC 36 Request for Comment on IASB Request for Information on Post-implementation Review - IFRS 13 *Fair Value Measurement*.

HoTARAC has found that the requirement for Australian public sector reporting entities to meet the requirements of accounting standards in respect to fair value measurement have imposed considerable costs on preparers, which are not justified in meeting the qualitative characteristics of financial information. HoTARAC has suggested the IASB consider the issue of reliability of fair value measurement.

In addition, HoTARAC recommends the AASB relax the requirements on public sector entities to justify a fair value measure or to undertake an exhaustive search to prove a fair value measurement cannot be obtained.

Please find attached HoTARAC's comments for the AASB and for your information HoTARAC's comments for the International Accounting Standard Board (IASB).

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Department of Finance on (02) 6215 3551 or peter.gibson@finance.gov.au.

Yours sincerely

Stephen Miners
ACTING CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

29 August 2017

COMMENTS FOR THE AASB

HoTARAC appreciates the efforts the AASB has made to date to lower the reporting burden for public sector entities undertaking fair value measurements.

In HoTARAC's view, the current reporting regime for fair value measurements for not-for-profit public sector entities is not meeting the key qualitative characteristics of relevance, reliability and understandability.

RELEVANCE

As acknowledged in Aus 49.1 of the conceptual framework, many public sector assets are held for their service potential. In these circumstances, fair values are of limited relevance and the critical factor for the users is the ability of the entity to use the asset to provide services. Consequently, detailed disclosures required for fair value are similarly of limited relevance to users. Notwithstanding this, and given the longevity of many public sector assets, fair value is more useful for decision-making than historic cost.

HoTARAC also notes that there may be circumstances in which a fair value measurement meeting the requirements of AASB 13 *Fair Value Measurement* bears little resemblance to what the asset would be exchanged for in a market transaction. For example, estimating the cost of a defence weapon system by breaking the asset into its component parts and including an allowance for obsolescence and other factors is unlikely to represent a market price or convey useful information to users on the capability of the asset.

RELIABILITY

Because the public sector typically does not supply goods or services to a competitive market or generate significant cash flows, fair value measurements for property, plant and equipment are typically undertaken using depreciated replacement cost with Level 3 inputs. Obtaining a robust valuation that meets audit requirements usually requires engaging a professional valuer, often at considerable expense. Even in these circumstances, HoTARAC's experience is that different valuers may arrive at different valuations of the same asset. Additionally, as noted in HoTARAC's response to the IASB's questions, it can be very difficult to demonstrate circumstances where reliable measurement is not possible. Accordingly, and as recommended to the IASB, additional guidance on the circumstances where a reliable measurement cannot be obtained would be useful.

Where an independent professional valuer is engaged, many of the disclosures in AASB 13 related to reliability become less relevant. HoTARAC acknowledges that some disclosures, such as the use of unobservable inputs will be relevant even where a valuer is used.

UNDERSTANDABILITY

Users of public sector financial statements typically do not possess extensive financial backgrounds. Many of the disclosures required by AASB 13 require a detailed knowledge of the standard, and accounting more broadly. As a result, most fair value disclosures in AASB 13 are of very limited use to the users of public sector financial statements.

COST CONSTRAINTS

Application of the qualitative characteristics is constrained by the cost of providing financial information.

AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires public sector reporting entities to apply fair value to harmonise with Government Finance Statistics (GFS). HoTARAC's experience is that meeting the requirements of audit in respect to justifying fair value measurements and the extensive disclosure requirements of AASB 13 have imposed significant costs on preparers, with little benefit to users. HoTARAC notes that the requirements of GFS in respect to market value measurements are far less stringent than those applying under accounting standards.

RECOMMENDATION

HoTARAC suggests that the AASB consider the circumstances in which a reliable measurement of fair value is not possible for assets held for their service potential. Consideration could be given to reducing costs by either not requiring reporting entities to undertake exhaustive efforts to prove a fair value cannot be obtained or not requiring exhaustive efforts to justify a fair value for these assets. This would be philosophically consistent with paragraph 17 of AASB 13 not requiring exhaustive efforts to identify the principal market.

HoTARAC may also have other recommendations relevant to the Australian public sector context, such as measurement bases under AASB 1049, and detailed recommendations in respect of fair value disclosures in the future.

GENERAL COMMENTS FOR THE IASB

In HoTARAC's view, the review of the current reporting regime for fair value measurement should consider whether the information provided satisfies the key qualitative characteristics of relevance and reliability.

RELEVANCE

HoTARAC notes that there may be circumstances in which a fair value measurement meeting the requirements of IFRS 13 *Fair Value Measurement* bears little resemblance to what the asset would be exchanged for in a market transaction. For example, estimating the cost of a bespoke machine by breaking the asset into its component parts and including an allowance for obsolescence and other factors may be the only practical way to assess fair value of such equipment. However, it is unlikely to represent a market price or convey useful information to users on the capability of the asset.

RELIABILITY

Obtaining a robust valuation for depreciated replacement cost that meets audit requirements usually requires engaging a professional valuer, often at considerable expense. Even in these circumstances, HoTARAC experience is that different valuers may arrive at different valuations of the same asset. Where an independent professional valuer is engaged, many of the disclosures in IFRS 13 related to reliability become less relevant.

COST CONSTRAINTS

Application of the qualitative characteristics is constrained by the cost of providing financial information. HoTARAC's experience is that meeting the requirements of audit in respect to justifying fair value measurements and the extensive disclosure requirements of IFRS 13 have imposed significant costs on preparers, with little benefit to users.

RECOMMENDATION

HoTARAC suggests that the IASB determine circumstances in which a reliable measurement of fair value is not possible for assets. Consideration could be given to reducing costs by not requiring reporting entities to undertake exhaustive efforts to prove a fair value cannot be obtained. This would be philosophically consistent with paragraph 17 of IFRS 13 not requiring exhaustive efforts to identify the principal market.

COMMENTS ON SPECIFIC MATTERS FOR THE IASB

Question 1A—Your background
Please tell us: (a) your principal role in relation to fair value measurement. For example, are you a preparer of financial statements, auditor, valuation specialist, user of financial statements, regulator, standard-setter, academic or a professional accounting body? If you are a user of financial statements, what kind of user are you (for example, buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, and asset or portfolio manager)? (b) your principal jurisdiction and industry. If you are a user of financial statements, which geographical regions and industries do you follow or invest in?

(a) HoTARAC members are primarily preparers of financial statements.

(b) HoTARAC members prepare financial statements for the Australian Government and State and Territory governments. HoTARAC members also act as advisors on accounting issues to individual reporting entities within their respective jurisdictions, and as policy setters to those entities where additional guidance/consistency is required regarding the application of accounting standards. Under Australian Accounting Standards, a single set of standards, based on IFRS, applies to both 'for profit' and 'not-for-profit' sectors.

Question 1B—Your experience

How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?

Type of item	**The extent of your experience with fair value measurements**		
	Little	**Some**	**Much**
Property, plant and equipment			✓
Intangible assets including goodwill		✓	
Investment properties		✓	
Biological assets	✓		
Investments in subsidiaries, joint ventures or associates		✓	
Financial instruments			✓
Other (please specify which)			

Question 2—Fair value measurement disclosures
(a) How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why. (b) In your experience of Level 3 fair value measurements: (i) how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response. (ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response. (iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided? (c) Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain. (d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

(a) HoTARAC finds the information provided in Level 3 fair value of limited usefulness. In HoTARAC's view the focus should be on a clear definition of what constitutes a reliable measurement of fair value and to what extent disclosure addresses issues of unreliability. HoTARAC considers that where a reported figure purports to be fair value users should have a reasonable degree of confidence that this would be the price the asset/liability would be exchanged in a competitive market. HoTARAC does not consider disclosures can fully overcome an unreliable measure, as discussed in the IASB's conceptual framework project[1].

(b)

(i) HoTARAC believes a certain amount of aggregation is necessary, so users are not overwhelmed with low value information on measurement techniques.

(ii) HoTARAC's experience is that reliable measurement is not always possible where market inputs are unavailable. In particular, where a depreciated replacement cost is used for specialised assets with bespoke components. HoTARAC has also found that descriptions of valuation techniques are of limited benefit to users as they require quite sophisticated understanding of valuation methods.

(iii) HoTARAC recommends IASB clearly define reliable measurement for fair value. Where an entity has an accounting policy of using fair value this would assist in determining circumstances where it is not possible to arrive at a fair value measurement and historic cost should be used.

(c) HoTARAC has found the disclosures of paragraph 93 of IFRS 13 costly to prepare and of little benefit to users. HoTARAC has found the Level 3 reconciliation of 93(e) particularly time-consuming and difficult to apply consistently. In HoTARAC's view, if the additional disclosures are necessary to inform users of the uncertainty associated with Level 3 measurements, this would be more appropriately addressed through providing clearer guidance on reliable measurement and circumstances in which this is not possible.

(d) HoTARAC thinks current disclosures are comprehensive.

---

[1] http://www.ifrs.org/-/media/project/conceptual-framework/exposure-draft/published-documents/ed-conceptual-framework.pdf

Question 3—Prioritising Level 1 inputs or the unit of account
(a) Please share your experience to help us assess: (i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples). (ii) whether there are material differences between fair value amounts measured on the basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences. (iii) if there are material differences between different measurements, which techniques are used in practice and why. Please note whether your experience is specific to a jurisdiction, a region or a type of investment. (b) The Board has undertaken work in this area in the past (see Appendix 3). Is there anything else relating to this area that you think the Board should consider?

(a)

(i) HoTARAC represents preparers of government financial statements, with a policy of measuring subsidiaries, joint ventures and associates at fair value. Quoted prices generally do not exist for such investments.

(ii) As HoTARAC represents government entities, subsidiaries rarely have a quoted price. If cash flows cannot be reliably estimated, subsidiaries are often valued at their net assets.

(iii) HoTARAC's experience is that the measurement of entities using net assets can be significantly different from other valuation techniques, particularly where an entity is in its start-up phase and is making temporary losses.

(b) Again, HoTARAC would recommend the Board address the issue of reliable measurement where a PxQ measurement is not available. For example, entities routinely prepare discounted cash flow analysis when assessing whether to proceed with an investment and some guidance on when this constitutes reliable measurement would be useful.

Question 4—Application of the concept of highest and best use for non-financial assets
Please share your experience to help us assess: (a) whether the assessment of an asset's highest and best use is challenging, and why. Please provide examples to illustrate your response. (b) whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary. (c) whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances. (d) whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises. Please note whether your experience is specific to a jurisdiction, a region or a type of asset.

Question 4 - continued

(a) HoTARAC has found that an asset's highest and best use is almost always its current use. However, in applying the concept of "legally permissible", different views exist about how Government imposed restrictions over an asset (which often applies to land) should impact on the valuation. Generally, a restriction imposed by Government could also be lifted or changed, which may make a significant difference to the range of potential uses of the asset. However, where there is no current plan for lifting or changing the restriction, how should the restriction be reflected in the valuation? Another example of a restriction is where a contract has been entered into to sell an asset (currently in use) for a nominal amount at a distant date. There are different views about how it should be taken into account for that asset's valuation while it is still being used by the same entity, until the agreed sale date.

(b) In most cases, the assets' current use is their highest and best use.

(c) HoTARAC has not encountered this counter intuitive result.

(d) HoTARAC members usually engage valuers where fair value is not determinable from Level 1 inputs, so there is little variation in the methodology used. Nevertheless, HoTARAC has noted that independent valuers can arrive at widely different values for the same asset, particularly where market inputs are not used.

Question 5—Applying judgements required for fair value measurements
Please share your experience to help us assess the challenges in applying judgements when measuring fair value: (a) is it challenging to assess whether a market for an asset or a liability is active? Why, or why not? (b) is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not? Please provide specific examples to illustrate your response and note whether your experience is specific to a jurisdiction or a region or a type of asset or liability.

(a) HoTARAC typically engages valuers to measure fair values. HoTARAC is not aware of valuers encountering significant difficulties in:
  a. Assessing whether the market for an asset/liability is active
  b. Assessing whether inputs are observable and significant

(b) While assessing whether an input is unobservable has not been a significant issue for HoTARAC, members have observed that the use of these inputs often result in a wide range of estimates of fair value, even where professional valuers are engaged. This raised questions about reliability.

Question 6A—Education on measuring biological assets at fair value
Please describe your experience of measuring the fair value of biological assets: (a) are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response. (b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

HoTARAC members do not have significant biological assets.

Question 6B—Education on measuring unquoted equity instruments at fair value
Please describe your experience of measuring the fair value of unquoted equity instruments: (a) in 2012, the IFRS Foundation Education Initiative published *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments? (b) do you have questions not covered in *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

(a) As representatives of public sector reporting entities, HoTARAC members frequently hold unquoted equity instruments. HoTARAC members and experts engaged by them frequently utilise the techniques outlined in *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*.

(b) HoTARAC would recommend the guidance be enhanced by addressing, and providing examples of, situations where fair value measurement is not possible.

Question 7—Effects and convergence
(a) Please share your experience of the overall effect of IFRS 13: (i) what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any adjustments you make to the measurements. (ii) what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period? (iii) what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why? (b) Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.

(a)

(i) HoTARAC represents public sector reporting entities. User needs are less focussed on cash flows in these circumstances, particularly where the entity is not-for-profit.

(ii) HoTARAC has not noticed significant changes in the comparability of fair value measurements.

(iii) As HoTARAC represents the public sector, it typically has a large number of Level 3 valuations. HoTARAC has found the detailed disclosure requirements associated with these valuations have increased compliance costs, with little benefit to users.

(b) HoTARAC represents Australian public sector entities which are not affected by convergence with US GAAP.

Question 8—Other matters
Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

HoTARAC recommends the Board consider guidance on what constitutes obsolescence, as this is critical to the application of current replacement cost.

HoTARAC would also prefer standard-setter guidance about the extent to which valuations should be aligned to costs initially capitalised. A frequent experience is that the (efficient) cost of an asset including all capitalised costs (on Day 1), exceeds the fair value determined in accord with IFRS 13 (on Day 2), when there has been no change to the asset. For example, Governments and other large organisations often incur non-repeatable relocation and/or re-establishment costs on acquired assets in order to progress a project in a remote location. Perhaps this demands additional guidance on what costs are truly "directly attributable" to getting an asset to the location and condition desired.

HoTARAC would also like guidance on how/whether an agreement to transfer an asset (e.g. land) in the future for a nominal amount may affect the valuation of the asset (refer Q4 (a)).