Webcast:

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

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Introduction

- Overview of proposals in ED 320
- Virtual roundtable discussions in May 2022

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Objective of ED 320

- Add **authoritative implementation guidance to AASB 13 *Fair Value Measurement***
- In respect of non-financial assets of **not-for-profit (NFP) public sector entities not held primarily for their ability to generate net cash inflows** (ie assets held primarily for their service potential)
- Propose guidance on:
  - market participant assumptions to use
  - the asset's highest and best use (HBU)
  - application of the cost approach.

Scope of ED 320

- Proposed guidance is intended to apply only to **NFP public sector entities**
- However, the AASB would like to know whether it would also be appropriate for the proposed guidance to apply to **NFP <u>private</u> sector entities**

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Why is guidance needed on market participant assumptions and HBU?

AASB 13.27 – A fair value measurement (FVM) of a non-financial asset takes into account a **market participant's** ability to generate economic benefits by using the asset in its **HBU** or by selling it to another market participant that would use the asset in its HBU.

Stakeholders' comment – Many assets of NFP public sector entities provide services **unique to the public sector holder of the asset**, therefore **unlikely**:

- to have an identifiable market participant other than the holder of the asset;
- for the market selling price of these assets to be directly observable because they are rarely sold; and
- to be used for another purpose (ie current use = HBU).

Market participant assumptions

- AASB 13.23 – an entity need not identify who are the market participants for the asset subject to measurement (the subject asset)
- AASB 13.61 – maximise the use of relevant observable inputs and minimize the use of unobservable inputs
- Some **unobservable inputs** would often be necessary where another identifiable market participant is unlikely to exist (eg the subject asset is specialised to provide services unique to its holder)
  - → ED 320 proposes guidance on the **market participant assumptions to use** when developing unobservable inputs

Market participant assumptions (cont.)

ED 320 paragraphs F4–F7

When developing **unobservable inputs**, the entity:

- uses its **own assumptions as a starting point**; and
- **adjusts those assumptions** if reasonably available information indicates that **other market participants would use different data**

If **no relevant information** about assumptions of other market participants is reasonably available, the entity would **use its own data** in developing unobservable inputs.

Market participant assumptions (cont.)

Goals of ED 320 paragraphs F4–F7 are to:

- re-express the guidance in AASB 13.89 → to permit the use of the entity's own data in developing unobservable inputs without needing to incur exhaustive efforts to identify other market participant data
- clarify when the search for assumptions of other market participants ends
- consequently, reduce the cost and effort required to identify which market participant assumptions to use.

Do you agree?

HBU: Rebuttable presumption

- AASB 13.29 – An entity's **current use** of a non-financial asset **is presumed to be its HBU** unless **market or other factors** suggest that a different use by market participants would maximise the value of the asset.
- Guidance to avoid incurring the cost of considering whether the 'market or other factors' referred to in AASB 13 para. 29 might exist.

ED 320 paragraphs F9–F11

The presumption in AASB 13.29 that an asset's current use is its HBU is **rebutted** only when → 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**

Do you agree?

Application of the cost approach: calculating an asset's current replacement cost (CRC)

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Assumed location of asset measured at CRC

- AASB 13 does not specify whether fair value measurements under the cost approach should assume continued use of the asset in its existing location.
- Stakeholders have requested guidance on:
  - whether an item of real property should be assumed to be replaced in the **most economical manner**; and therefore,
  - assumed to be replaced in a cheaper location, if the services can be delivered in a cheaper location.
- Stakeholders expressed concerns about the cost, complexity and auditability of choosing from a potentially large range of alternative locations.

Assumed location of asset measured at CRC (cont.)

ED 320 paragraph F14(a)

When measuring an asset (e.g. an item of real property) of an NFP public sector entity using the cost approach (at CRC) the entity assumes the asset will be replaced in its **existing location**, even if it would be feasible to replace the asset in a cheaper location.

Do you agree?

Nature of the component costs to include in an asset's CRC

ED 320 paragraphs F14(b) and F14(c) – General principles:

Assume the subject asset presently does not exist and all components of the asset need to be replaced based on its existing service capacity at the measurement date → **All necessary costs intrinsically linked to acquiring or constructing the subject asset** at the measurement date are included in the asset's CRC.

CRC of subject asset = Estimated cost of reference asset (modern equivalent asset/replica asset) − differences in current service capacity of the reference asset & subject asset

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 paragraph F15(a) – Once-only costs:

- Because all necessary costs intrinsically linked to acquiring or constructing the subject asset are included in the asset's CRC → **'once-only costs' are included** in the asset's CRC
- 'Once-only costs' → costs of parts of an asset not expected to actually be replaced in the future
- Consistent with the exchange transaction in fair value being a **hypothetical transaction**, based on current market conditions

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 paragraph F15(b) – Other costs to consider:

Necessary costs intrinsically linked to acquiring or constructing the subject asset, including:

- costs of removal & disposal of any **unwanted existing structures on land**; and
- disruption costs → **including costs to restore an asset not controlled by the consolidated group (if any) to which the entity belongs**.

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 illustrative example 1

Council A controls a road to which the following costs (measured using prices as at that measurement date) relate:

	Estimated cost $'000	
Design work	2,200	Once-only costs
Earthworks	10,000	
Formation	5,000	
Pavement	3,000	
Surfacing	2,000	
Disruption of traffic	1,000	Disruption costs
Total	**23,200**	

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 illustrative example 1 – Costs of removal and disposal of unwanted existing structures

- Assume Council A's road is situated in a densely populated area, and there are **no vacant sites** in the surrounding area
- To construct the road in a hypothetical acquisition, a market participant buyer would need to incur $1,000,000 to remove and dispose of unwanted structures on land
  - → Council A includes the $1,000,000 estimated costs of removal and disposal of the unwanted existing structures in the road's CRC
  - → It is reasonable to expect that a market participant buyer would need to incur such costs if it was to construct a substitute road at the subject asset's existing location, since there is no vacant land available in the area

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 illustrative example 2 – Restoration costs for disrupted assets of another entity

- Assume that if the road was to be replaced at the measurement date, the drainage works under the road that belong to another entity would be disrupted
- The current cost required to restore those drainage works is $2,500,000
    - → Council A includes in the road's CRC the $2,500,000 restoration costs
    - → However, those restoration costs would be excluded from the road's CRC if the drainage works were controlled by the consolidated group (if any) to which Council A belongs (to avoid double counting those costs in the group's financial statements)

Nature of the component costs to include in an asset's CRC (cont.)

ED 320 paragraph F15(c) – Consider the entity's expected manner of replacement

Calculate an asset's CRC based on the entity's **expected manner of replacement in the ordinary course of operations**, rather than the **theoretically cheapest** legally permitted cost

Do you agree?

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Economic obsolescence under the cost approach

ED 320 paragraphs F16–F17

Economic obsolescence should not:

a) be identified if the asset has apparent 'excess capacity' that is necessary for **standby or safety purposes**; and

b) be limited to circumstances in which a **formal decision** has been made to reduce the asset's physical capacity.

Do you agree?

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Transition and effective date

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Transition and effective date

- The authoritative implementation guidance to be applied **prospectively**
- For annual periods beginning on or after **1 January 2024**, with earlier application permitted.

Your input is important to us!

Please consider:

- attending one of the virtual roundtable discussions; and/or
- submitting comments to the AASB on ED 320.

Virtual roundtable discussions

- Three virtual roundtables to discuss ED 320 proposals by grouped jurisdictions:
  - Tue 24 May 10am–12pm (AEST): Commonwealth public sector entities and entities in NSW and ACT
  - Wed 25 May 10am–12pm (AEST): entities in VIC, QLD and TAS
  - Thu 26 May 3pm–5pm (AEST): entities in WA, SA and NT
- Registration details can be found on the AASB's **upcoming events page:** https://aasb.gov.au/news-events/upcoming-events/
- Please submit written comments on ED 320 by Thursday **30 June 2022** on this page: https://www.aasb.gov.au/current-projects/open-for-comment/submit-comment-letter/?id=2560

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Thank You

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