



Project:	Fair Value Measurement for NFP Public Sector Entities	Meeting:	AASB September 2022 (M190)
Topic:	Market participant assumptions	Date of this paper:	5 September 2022
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		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider feedback on Exposure Draft

Objectives of this paper

1. In respect of the application of the **market participant assumptions** principle for measuring the fair values of not-for-profit (NFP) public sector entity assets,¹ the objectives of this paper are for the Board to:
 - (a) **consider** stakeholder feedback received on the proposed implementation guidance (IG) in ED 320² (questions 3 and 4 of ED 320); and
 - (b) **decide** on any modifications to AASB 13 *Fair Value Measurement* for the purposes of finalising the Amending Standard.

Overview of ED responses and staff recommendations

2. Eleven ED respondents³ included a response to the Specific Matter for Comment (SMC) questions 3 and 4 related to proposed IG on the market participant assumptions principle:

Agree	Not completely agree/disagree	Disagree	No comment
7 S2–APV S3–HoTARAC S6–PwC S9–CA & CPA S12–ACAG S13–ABS S15–Deloitte	3 S4–EY S8–IPA S10–API	1 S14–Liquid Pacific	5 S1– Cessnock City Council S5–Blacktown City Council S7–KPMG S11–Local Gov’t Professionals NSW S16–Tony Blefari

1 For ease of reference, unless otherwise stated, each ‘asset’ referred to in this paper relates to a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows.

2 ED 320 [Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities](#)

3 The Board received 16 written submissions on ED 320, which have been compiled as Agenda Paper 8.7 in the supplementary folder.

3. Based on the feedback received, staff recommend the Board:
 - (a) confirms its proposal to add IG in AASB 13 to assist NFP public sector entities to apply the market participant assumptions principle; and
 - (b) simplifies and clarifies the wording of the proposed IG.

Structure of this paper

4. This paper is set out as follows:

Part A: Proposed IG on the market participant assumptions principle

Section 1: Background – The Board’s considerations in developing ED 320

Section 2: Stakeholder feedback and staff comments thereon

Section 3: Staff recommended changes to paragraphs F4–F7 of ED 320

Part B: Examples of assets that are likely to require an entity to develop unobservable inputs using its own assumptions (paragraph F8 of ED 320)

Part A: Proposed IG on the market participant assumptions principle

Section 1: Background – The Board’s considerations in developing ED 320

5. The Board proposed IG in ED 320 in response to stakeholders’ requests for guidance to assist their application of the market participant assumptions principle “where a public sector entity’s asset has few or no market participants (other than the holder of the asset) and where information about market participants’ inputs to a current replacement cost model may be scarce” (ED 320, paragraph BC7(a)).
6. Those requests reflected stakeholders’ concerns that, for a range of assets of NFP public sector entities, especially when such assets are specialised/infrastructure providing unique services:
 - (a) market participants other than the holder of the asset often are not evident; and
 - (b) market selling prices of many such assets, or suitable reference assets, are unlikely to be directly observable. (ED 320, paragraph BC24)
7. The Board decided to propose paragraphs F3–F7 in ED 320 (reproduced in the box below) to:
 - (a) step through the process of maximising observable inputs and minimising unobservable inputs in measuring the fair value of an asset;
 - (b) reflect the principle in AASB 13 that, if data about other market participants are not available, the entity would need to develop unobservable inputs to measure the fair value of such assets;
 - (c) confirm that, in accordance with AASB 13 paragraph 89, when developing unobservable inputs, an entity may begin with its own data and adjust those data if reasonably available information indicates that other market participants would use different data; and
 - (d) re-express the guidance in AASB 13 paragraph 89 – so that an entity’s own assumptions are required to be used as a starting point (if some relevant information about other market participant assumptions needed to estimate the fair value of the asset is not reasonably available) to:
 - (i) reduce the potential for confusion regarding when the search for assumptions of other market participants ends, and

- (ii) reduce the cost and effort required to identify which market participant assumptions to use in measuring the fair value of non-financial assets not held primarily for their ability to generate net cash inflows [ED 320 paragraph BC30].

Market participant assumptions (paragraphs 22 and 23, 61 and 89)

F3	Paragraph 22 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. Paragraph 23 states that, in developing those assumptions, an entity need not identify specific market participants; and paragraph 89 states that (in relation to unobservable inputs for an asset) an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.
F4	For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows:
	(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, as referred to in paragraph 22) shall be used to estimate the fair value of the asset; and
	(b) if the market selling price of an identical asset is not directly observable, the entity explicitly estimates the pricing assumptions that other market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.
F5	For a non-financial asset of the type referred to in paragraph F4, in applying the principles in paragraphs 61 and paragraph F4(b) to maximise the use of relevant observable inputs and minimise the use of unobservable inputs:
	(a) if all relevant information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available, the entity shall use those assumptions in measuring the fair value of the asset. For example, the entity uses the observable market price of a comparable asset to measure the fair value of the asset subject to measurement, by adjusting for the differences between the comparable asset and the asset subject to measurement using relevant market data; or
	(b) 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 shall use its own assumptions as a starting point and make adjustments to those assumptions if reasonably available information indicates that other market participants would use different data.
F6	For the purpose of paragraph F5(b), if no relevant information about other market participant assumptions is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset.
F7	For the purposes of paragraphs F5 and F6, exhaustive efforts need not be undertaken to identify whether relevant information about other market participant assumptions is reasonably available or whether the entity's own data should be adjusted.

Section 2: Stakeholder feedback and staff comments thereon

Reasons for supporting the proposed IG

8. Of the 11 respondents who responded to SMC 3, seven respondents agreed with the guidance proposed. Three of those respondents provided the following reasons for their view:
- (a) The proposals would provide clarity in the steps to be taken to measure the fair value of a non-financial public sector asset and should make the application of AASB 13 requirements more practical. [S9–CA & CPA, S15–Deloitte]

- (b) Agree with the general principles that a valuation technique applied is appropriate to specific circumstances of the asset and for which sufficient data are available to measure fair value. [S13–ABS]
- (c) In many instances, there is no obvious market for NFP public sector assets and inputs arising from identified external market participant assumptions are unlikely to be relevant or reliable if available at all. Using the entity's own assumptions is reasonable, particularly for highly specialised assets. [S15–Deloitte]
- (d) The proposals would provide a useful framework to ensure NFP public sector entities are considering market participant assumptions where they are available, but are not burdened with trying to identify assumptions that practically may not exist. [S15–Deloitte].

Reasons for disagreeing with the proposed IG

9. The respondent that disagreed with the guidance proposed (S14–Liquid Pacific) stated that they “disagree that an entity would not find any relevant information on which to base their assumptions”, and that it is unclear what alternatives the AASB is contemplating when it states “the entity should use its own assumptions in measuring the fair value of the asset”.
10. This comment might stem from paragraph F6 in ED 320, which states that “...if no relevant information about other market participant assumptions is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset.” [emphasis added] Staff observe that this statement is consistent with the wording in paragraph 89 of AASB 13 *Fair Value Measurement* – which states that “the best information available in the circumstances ... might include the entity's own data”.

Other comments on the draft IG in paragraphs F4–F7

11. Three other respondents did not clearly agree or disagree with the proposed guidance in paragraphs F4–F7 of ED 320. Those respondents suggested further clarification of the guidance. Their responses and staff's comments thereon are noted in paragraphs 12–26.
12. S4–EY commented that the guidance in paragraphs F4–F7 is unnecessary because those paragraphs do not add anything to the existing guidance in AASB 13.
13. **Staff comment:** The proposed guidance on market participant assumptions in ED 320 was supported by the majority of the respondents who responded to SMC 3, and therefore staff recommend providing IG on this topic. However, staff observe that similar comments were made by some roundtable participants that paragraphs F4 – F6 do not provide much practical assistance to entities applying the current requirements of AASB 13, and consider that the drafting of those IG paragraphs could be improved (see staff comment in paragraph 17 below).
14. S10–API commented that paragraphs F4–F6 are framed in terms of whether a market selling price of an identical asset is directly observable, i.e. whether Level 1 inputs exist – however, Level 1 inputs do not exist for non-financial assets (even real property).
15. One person made a similar comment at a roundtable discussion – that only financial assets could have an identical asset; there would not be an identical asset for a non-financial asset.

Staff comment

16. Staff observe that the intention of referring to identical assets was to identify circumstances in which (in principle) it would be unnecessary to consider the assumptions of other market participants. However, staff agree with those comments from the API and that roundtable participant in terms of practical application.

17. Therefore, staff recommend deleting from the IG the discussion of identical assets, and consequently omitting paragraph F4 so that the guidance would focus more sharply on the circumstance in which the Board proposes requiring an entity to start with its own assumptions and make adjustments to those assumptions to reflect different data used by other market participants. [Please refer to the proposed draft paragraph F6 below.]
18. S8–IPA commented that how paragraph F5 is currently drafted may have unintended consequences because it would require an entity to consider whether ‘all’ relevant information about market participant assumptions is reasonably available, which may be a difficult hurdle for an entity to comply with. It would be more effective if the word ‘substantially’ or ‘significantly’ is used instead.
19. A similar comment regarding the use of the word ‘all’ relevant information about market participant assumptions was made by a participant in the roundtable discussions. That participant expressed concern that paragraph F5 seems to be written for application at a whole-of-asset basis, rather than a ‘per input’ basis – i.e. it is unclear whether paragraph F5 states that if a fair value measurement fails the test of “all relevant information about other market participant assumptions ... [being] reasonably available”, paragraph F5(b) must be applied and only unobservable inputs must be used.
20. **Staff comment:** Staff consider that the drafting of the guidance could be improved to avoid the need to consider whether all information is reasonably available. Consequently, staff recommend stating that, for assets with different parts, observable market data might be available for some parts, in which instances unobservable inputs would only be used to estimate the fair value of the remainder of the parts. [Please refer to proposed draft paragraph F8 below.]
21. One ACAG jurisdiction, while agreeing with the proposed paragraphs F4–F7, suggested modifying the guidance to expand paragraph F5(a) to state that a market participant is not readily identifiable when the holder of the asset is a monopoly service provider in their geographical area. This would avoid discussions on whether divergent assumptions made in other local governments/States are relevant.
22. **Staff comment:** Staff recommend not to provide IG or other commentary that another market participant is not readily identifiable when the current asset holder is a monopoly service provider in their geographical area. A lack of market data about land in a similar geographical location (which would seem unusual) would probably affect the ability to identify the assumptions of other market participants about a subject parcel of land. However, it is not obvious that a lack of market data about infrastructure (non-land) assets in a similar geographical location to a subject infrastructure asset would preclude using prices for similar infrastructure assets in distant locations as inputs to assessing the assumptions of other market participants. Consequently, staff consider that determining whether this is the case is a matter for detailed valuation assessments in the circumstances of each subject asset.
23. S12–ACAG, in its response to General Matter for Comment question 26, commented that whether the proposals create any auditing or assurance challenges – it noted that “... there may be an incentive for entities to assess that information about market participants is not ‘reasonably available’ when it may be available to avoid market valuations in order to adopt their own assumptions as holder of the asset.”

Staff comment

24. Staff observe that the issue of possible incentive for an entity to assess that information about market participants is not reasonably available exists in the current AASB 13 text, because paragraph 89 of AASB 13 permits an entity to use its own assumptions as a starting point in developing unobservable inputs.

25. The IASB noted in paragraph BC175 in its Basis for Conclusions for IFRS 13 that “... IFRS 13 states that such exhaustive efforts [to obtain information about the assumptions that market participants would use when pricing the asset or liability] would not be necessary. **However, when information about market participant assumptions is reasonably available, an entity cannot ignore it.**” [clarification and bolding added]
26. Staff consider that whether information about market participants is ‘reasonably available’ is a matter of judgement. However, consistent with the IASB’s views noted above, the IG could specify that an entity cannot ignore market participant information that is reasonably available. [Please refer to proposed draft paragraph F7 below.]

Staff analysis

27. Based on the feedback received, staff consider that:
- (a) there is strong support for the Board to add IG to AASB 13 to assist NFP public sector entities to apply the market participants assumptions principle – in particular, support for adding IG to explain when an entity is permitted/required to use its own assumptions as a starting point for measuring the fair value of an asset; however,
 - (b) the drafting of the IG needs to be simplified and clarified.
28. The specific ways in which staff suggest to simplify the guidance are included in Section 3.

Section 3: Staff recommended changes to paragraphs F4–F7 of ED 320

29. Staff recommend amending the proposed IG on market participant assumptions as follows:
- (a) deleting paragraph F4 of ED 320 about the circumstances in which the market selling price of an identical asset is directly observable because it seems to be of little practical relevance. Instead, revising the IG to focus more clearly on the circumstances in which fair value measurements require the use of at least some unobservable inputs (illustrated in paragraphs F5 and F6 of the draft amended guidance below);
 - (b) revising paragraph F5 of ED 320 so that the conditions for when an entity is required to use its own assumptions as a starting point for measuring the fair value of an asset are dependent on whether market selling prices or other market data are observable for the subject asset, rather than solely relying on whether “all information about other market participant assumptions needed to estimate the fair value of the asset is reasonably available” (illustrated in paragraph F6 of the draft amended guidance below).
 - (c) the reasonable availability of other market participant data would then become a criterion for amending an entity’s own assumptions, thus stipulating a two-step process, which should be more straight-forward to apply (illustrated in paragraph F6 of the draft amended guidance below); and
 - (d) adding proposed paragraph F8 below to clarify the issue concerning assets including some parts with observable inputs and other parts with only unobservable inputs, as explained in paragraph 20.

30. Draft amended guidance is included below for the Board's consideration. Because of their extent, the proposed changes are not marked up from the text of ED 320.

Market participant assumptions (paragraphs 22 and 23, 61 and 89)

- F3 Paragraph 22 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. Paragraph 23 states that, in developing those assumptions, an entity need not identify specific market participants; and paragraph 89 states that (in relation to unobservable inputs for an asset) an entity need not undertake exhaustive efforts to obtain information about market participant assumptions.
- F4 Unobservable inputs are defined as inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability. Paragraph 87 states that unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Paragraph 89 states that, in developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy).
- F5 Various non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, especially some that are specialised, do not have observable market selling prices or other observable market data because other entities seldom sell those assets until their economic life has expired (ie there is little market activity for the asset or comparable assets at the measurement date). Consequently, in applying the requirement of paragraph 61 for fair value estimates to maximise the use of relevant observable inputs, it may nonetheless be necessary to develop unobservable inputs to estimate their fair value. Moreover, for assets that are unique to a government, observable evidence of assumptions of other market participants, if any, is unlikely to differ from the entity's own assumptions.
- F6 Accordingly, when applying the principles in paragraphs 61 and 62 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, if:
- (a) the market selling price of a comparable asset is not observable; or
 - (b) not all other market participant data required to measure the fair value of the asset is observable,
- the entity shall 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.
- F7 For the purpose of paragraph F6, if no relevant information about other market participant assumptions is reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset. Exhaustive efforts need not be undertaken to identify whether relevant information about other market participant assumptions is reasonably available or whether the entity's own data should be adjusted. However, when information about market participant assumptions is reasonably available, an entity cannot ignore that information.
- F8 For the purpose of paragraph F6, for assets with different parts, observable market data might be available for some parts, in which instances unobservable inputs would only be used to estimate the fair value of the remainder of the parts. For example, the land component of a self-constructed specialised facility might have comparable land with an observable market price, but entity-specific data might be needed to measure the fair value of some or all of the other parts of the facility.

Questions for Board members

- Q1: Do Board members agree to confirm the Board's proposal to add IG in AASB 13 to assist NFP public sector entities to apply the market participant assumptions principle?
- Q2: Do Board members agree with the staff recommended changes to the IG described in paragraph 29?
- Q3: Do Board members have any comments on the staff suggested implementation guidance?

Part B: Examples of assets that are likely to require an entity to develop unobservable inputs using its own assumptions

31. When developing ED 320, the Board considered that providing a list of examples of assets that are likely to require an entity to develop unobservable inputs using its own assumptions would be useful to reduce the time and effort for preparers, valuers and auditors in debating whether there might be data about other market participant assumptions. Accordingly, the Board added paragraph F8 to ED 320:

F8	Examples of assets for which market selling prices of an identical or a comparable asset are unlikely to be directly observable and no relevant information about different assumptions of other market participants is likely to be reasonably available include infrastructure (eg roads, drainage and sewerage works), prisons, parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, community facilities (eg toilet blocks) and most defence weapon platforms.
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Respondent feedback

32. Four ED respondents provided comments on the examples provided in paragraph F8:
- (a) S4–EY and S14–Liquid Pacific commented that some of the examples, such as prisons, may not be relevant as some prisons are owned by private entities. Also, S4–EY commented that the government regularly sells defence weapon platforms and therefore these assets would often have observable market prices/information.
 - (b) S10–API commented that there is the potential to expand the examples to include other government assets such as hospitals, schools, court houses, sport stadiums, libraries, government houses.
 - (c) S12–ACAG commented that some off-the-shelf defence weapons platforms are actively traded and would have observable inputs. It considers that bespoke defence weapon platforms and purpose-built hospitals and schools should also be included as examples.
 - (d) S14–Liquid Pacific commented that the examples in paragraph F8 are not always assets “not held primarily for their ability to generate net cash inflows”.
 - (e) S14–Liquid Pacific commented that police stations and fire stations and libraries (not mentioned in ED 320 para. F8) generally have observable market inputs, and that parliament houses may be loosely referenced office accommodation in a similar location.

Staff comments and recommendations

33. Staff recommend:
- (a) amending paragraph F8 of ED 320 to align more closely with the core focus of the IG on market participant assumptions – that is, assets for which information about other market participant assumptions is unlikely to either be reasonably available or to differ from the entity’s own assumptions;
 - (b) removing prisons, fire stations, police stations and defence weapon platforms from the examples in paragraph F8. Although ‘bespoke’ defence weapons platforms would seem compatible with paragraph F8, staff recommend omitting reference to these assets since they are only held by one government;
 - (c) not adding a reference to ‘purpose-built’ assets because it would be difficult to define which assets are considered purpose-built; and
 - (d) not adding the API’s suggested examples of schools, hospitals, court houses and libraries since some respondents (e.g. S14–Liquid Pacific) have argued that market sales evidence would typically be observable for them (where there may be evidence of recent sales in nearby suburbs).

34. In relation to the scope concern raised by S14–Liquid Pacific – that the assets noted in paragraph F8 are not always “not held primarily for their ability to generate net cash inflows” – staff observe that paragraph F8 should be read in the context of paragraphs F3–F7 of ED 320, which are not intended to indicate that particular types of assets necessarily would, or would not, be held primarily for their ability to generate net cash inflows. For the avoidance of doubt, staff recommend explicitly limiting the scope of paragraph F8 to assets not held primarily for their ability to generate net cash inflows, by referring to paragraph F6 of the revised draft IG in paragraph 16.
35. The box below includes marked-up text showing staff’s recommended changes to paragraph F8 of ED 320 (which will become paragraph F9).

F8F9	For the purpose of paragraph F6, examples of assets for which market selling prices of an identical or a comparable asset are unlikely to be directly observable and no relevant information about different assumptions of other market participants information about other market participant assumptions is unlikely either to be reasonably available or to indicate that those assumptions differ from the entity’s own assumptions include infrastructure (eg roads, drainage and sewerage works), prisons, parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, <u>and</u> community facilities (eg toilet blocks) and most defence weapon platforms .
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Questions for Board members

- Q4: Do Board members agree to confirm the proposal in ED 320 to provide examples of assets that are likely to require an entity to develop unobservable inputs using its own assumptions?
- Q5: Do Board members have any comments on the staff’s suggested changes to paragraph F8 of ED 320?