Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Fair Value Measurement for NFP Public Sector Entities**	**Meeting:**	AASB September 2022 (M190)
Topic:	**Scope of the project**	**Date of this paper:**	5 September 2022
Contact(s):	Patricia Au pau@aasb.gov.au Jim Paul jpaul@aasb.gov.au Carmen Ridley cridley@aasb.gov.au	**Agenda Item:**	8.2
		Project Priority:	Medium
		Decision-Making:	High
		Project Status:	Consider feedback on Exposure Draft

Objectives of this paper

1. In respect of the measurement of not-for-profit (NFP) public sector entity assets,[1] the objectives of this paper are for the Board to:

   (a) **consider** feedback received on ED 320[2] about the scope of the project, specifically:

      (i) whether a non-market-participant-based entry price measurement basis might be more appropriate for measuring NFP public sector entity assets; and

      (ii) the Board's view that it should not mandate the measurement technique to apply for measuring the fair value of specific assets, including land and improvements on land subject to public-sector-specific legal restrictions; and

   (b) subject to consideration of Agenda Papers 8.3–8.6, **confirm** whether to modify AASB 13. If so, **confirm** the scope of the Amending Standard.

Introduction and structure of the paper

2. The Board included six General Matters for Comment (GMC) (questions 22–27) in ED 320. Seven ED respondents[3] included a response to one or more of those GMCs [S3–HoTARAC, S4–EY, S9–CA & CPA, S12–ACAG, S13–ABS, S14–Liquid Pacific, S15–Deloitte]. Their comments are summarised in the Appendix to this paper.

3. Respondents' comments on the GMCs that are related to the draft implementation guidance (IG) proposed in ED 320 are considered in other Agenda Papers for this item. However, a few respondents have raised comments relating to the scope of the project that warrant the Board's consideration. Accordingly, the subject of this paper is the scope of the project.

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.

4. Staff noted that even though almost all respondents expressed support for modifying AASB 13 to assist NFP public sector entities to apply the AASB 13 principles consistently, two ACAG jurisdictions suggested the Board should reconsider whether an entry price measurement model might be more appropriate than fair value for measuring certain NFP public sector assets.

5. In addition, some ED respondents considered that further guidance on, or modification of, AASB 13's requirements is needed regarding fair value measurement of land subject to public-sector-specific legal restrictions.[4]

6. Those comments are discussed in separate parts in this paper, as follows:

   (a) Part A discusses whether it might be more appropriate to measure NFP public sector assets by applying a non-market-participant-based entry price measurement basis instead of fair value.

   (b) Part B discusses respondents' feedback on the Board's view that it should not mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land. Part B is separated into four sections:

   - Section 1: The Board's considerations when developing ED 320
   - Section 2: Respondents' comments regarding the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets
   - Section 3: Respondents' comments on restricted land – mandating a specific measurement technique to apply
   - Section 4: Respondents' comments on restricted land – Adding specific guidance in the Amending Standard

   (c) Part C discusses other project-scope-related comments raised by individual respondents.

Overview of staff recommendations

7. Based on the feedback received, and subject to the Board's consideration of Agenda Papers 8.3–8.6, staff recommend the Board confirms its proposals:

   (a) to modify AASB 13 for NFP public sector entities;

   (b) not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land;

   (c) not to provide further guidance on the measurement of restricted land; and

   (d) not to undertake standard-setting action regarding the other issues raised by individual respondents noted in Part C.

4 For ease of reference, land subject to public-sector-specific legal restrictions is referred to in this paper as 'restricted land'. For the purpose of this project, public-sector-specific legal restrictions are restrictions that would restrict the use of an NFP public sector entity asset, or restrict the prices that an NFP public sector entity may charge for using an asset, and that would not be transferred to private sector entities in a hypothetical sale of the asset.

Part A: Non-market-participant-based entry value measurement basis

8. Even though almost all respondents expressed support for modifying AASB 13 to assist NFP public sector entities to apply the AASB 13 principles consistently:

   (a) Two ACAG jurisdictions, although supporting the proposals in ED 320, suggested the Board should reconsider whether an entry price measurement model might be more appropriate than fair value for measuring certain NFP public sector assets; and

   (b) S14–Liquid Pacific expressed a view that fair value and market value are the same and all valuation techniques would result in the same fair value (that is, measurement under market, income or cost approach should arrive at the same measure of fair value).

9. The two ACAG jurisdictions would like the Board "… to explore the notion of 'entry price' further and consider providing an optional relief from the requirements of paragraph 24 of AASB 13." AASB 13 paragraph 24 states: "Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique."

10. The ACAG comment letter noted the following comments from those two jurisdictions:

    (a) Although the proposals in ED 320 would provide relief from current processes, entities will still need to go through a process of determining whether market observable inputs are available. An exemption from considering market-participant-based exit price would "… result in a more cost-efficient valuation and a fair value that reflects the non-financial benefits of providing needed services to beneficiaries that are not captured in a market-based exit price (which for assets like roads and land under roads can be a decrement to entry price approaching 100%)."

    (b) "… given many public sector infrastructure assets are valued at current replacement cost, the introduction of the entry price notion, or providing an exemption from paragraph 24 of AASB 13, will likely result in the same outcome, however, this would be subject to further research and impact analysis by the AASB."

    (c) "The International Monetary Fund Government Financial Statistics Manual 2014 (IMF GFSM) and the Australian Government Financial Statistics Manual (AGFSM) … regard the market value of assets as an entry price. Such an exemption [from a market-participant-based exit value] would then provide clarity on the appropriate valuation technique to select for each asset class, including land."

    (d) In addition, one of those jurisdictions recommended the Board amends AASB 116 *Property, Plant and Equipment* to allow NFP public sector entities to use the 'written-down replacement cost', [5] which is an alternative GFS measurement model when directly observable prices for used assets are not available for measuring classes of assets measured using the revaluation model. (Paragraph 8.38 of the *Australian System of Government Finance Statistics: Concepts, Sources and Methods* 2015 (AFGSM))

Staff comment

11. Paragraph 8.38 of AFGSM explains an asset's written-down replacement cost as follows: "… The value of … an asset at a specific point in its life is given by the current acquisition price of an

5 The ACAG submission uses the term 'written-down current acquisition value', which is not the term used in AFGSM.

equivalent new asset minus the depreciation, amortisation, or depletion imputed by applying the chosen pattern of decline to that price …”.

12. Regarding the comments made by the two ACAG jurisdictions noted in paragraph 10, staff have the following observations:

(a) In May 2020, the Board issued ITC 45[6] to obtain views on whether Australian stakeholders would prefer that the Board adopts, in respect of current value measurement of NFP public sector entity assets:

(i) the IPSASB’s proposed current operational value measurement basis, which is an entity-specific entry value based on an asset’s current use; or

(ii) continues applying the fair value measurement basis, which is a market-participant-based exit value based on an asset’s highest and best use (HBU).

The feedback received on ITC 45, including NFP public sector entities’ financial statement preparers, auditors and valuers, indicated a majority of respondents consider that fair value under AASB 13 is appropriate for measuring the current value of all non-financial assets held by NFP public sector entities and should remain the sole current value measurement basis. The majority of ITC 45 respondents also commented that they agree with applying the HBU and market participants concepts under fair value for measuring the current value of NFP public sector assets, although some of them requested the Board to issue guidance to assist entities to understand better how these concepts should be applied in the NFP public sector context.

(b) ITC 45 respondents considered that applying the fair value basis to all non-financial assets, despite the need to exercise judgement in applying those concepts, would be preferable to applying two measurement bases (such as measuring assets not held primarily for their ability to generate net cash inflows using the IPSASB’s proposed measurement basis while measuring assets held for their financial capacity at fair value). This is because it would avoid:

(i) the need for financial statement preparers, auditors and valuers to understand the requirements of two measurement bases;

(ii) imposing potential additional costs and effort to assess which measurement basis is appropriate for each asset or class of assets, or to reassess the appropriate measurement basis when there is a change in how an entity uses an asset; and

(iii) reporting to users of financial statements of NFP public sector entities current values based on mixed measurement bases, which would reduce the comparability and understandability of the totals reported (ED 320 paragraph BC18).

(c) The cost approach under AASB 13, like the AFGSM’s written-down replacement cost, is an entry price measurement technique based on the current acquisition price of an equivalent new asset at the measurement date (albeit an entity needs to consider whether market participants would use different assumptions in pricing the asset). In this respect, staff consider that if the Board proceeds with its proposal to modify AASB 13 as discussed in Agenda Paper 8.4: Market Participant Assumptions – so that, for certain assets, an entity would be required to use its own assumptions as a starting point and adjust those assumptions only if reasonably available information indicates that other

6 ITC 45 Request for Comment on IPSASB Exposure Drafts ED 76 *Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements* and ED 77 *Measurement*

market participants would use different data – it should reduce the cost and effort required to measure the fair value of assets.

13. In respect of the comment made by S14–Liquid Pacific noted in paragraph 8(b), staff observed that opining on the relationship between the outcomes of applying the market, income or cost approach or whether fair value is the same as market value is a matter for valuation experts and not Australian Accounting Standards.

14. In addition, the IASB, in paragraph BC79 of its Basis for Conclusions on IFRS 13 *Fair Value Measurement*, noted circumstances in which a market price for a specialised asset, if available, would be unlikely to capture the value that the asset contributes to the business because that market price would not capture the specialised characteristics of the asset – that is, that market price would not represent fair value of the specialised asset. In such a situation, an entity will need to measure the fair value of the specialised asset using another valuation technique, such as an income approach or the cost approach to replace or recreate the asset depending on the circumstances and the information available.[7]

Staff recommendation 1

15. Staff observe that:

    (a) other than S14–Liquid Pacific, all other ED 320 respondents appear to welcome NFP public-sector-specific modifications to AASB 13 (to varying degrees);

    (b) achieving full compliance with IFRS 13 is not an important factor in the NFP public sector; and

    (c) almost all stakeholders (other than the two ACAG jurisdictions) who responded to ITC 45 and ED 320 expressed support for continuing to measure NFP public sector entity assets using a market-participants-based measurement basis; and therefore, a case has not been made to depart from fair value measurement.

16. Staff consider that, subject to the Board's consideration of Agenda Papers 8.3–8.5, an adequate case has been made to modify AASB 13 for NFP public sector entities. [Agenda Paper 8.6 discusses whether the proposals should be applied also to NFP private sector entities.]

17. Accordingly, staff recommend proceeding with the Board's proposal to:

    (a) retain fair value as the sole current value measurement basis for measuring non-financial assets; and

    (b) modify AASB 13 for NFP public sector entities.

Question for Board members

Q1: Do Board members agree to confirm the Board's proposals noted in paragraph 17? If not, please provide your alternative view and reasons for that view.

The remaining sections of this paper and Agenda Papers 8.3–8.6 for this item will be discussed only if the Board agrees with Question 1 to modify AASB 13 for NFP public sector entities.

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7 IFRS 13 paragraph BC79 states: "It is unlikely in such a situation that a market price, if available, would capture the value that the specialised asset contributes to the business because the market price would be for an unmodified asset. When a market price does not capture the characteristics of the asset (eg if that price represents the use of the asset on a stand-alone basis, not installed or otherwise configured for use, rather than in combination with other assets, installed and configured for use), that price will not represent fair value. In such a situation, an entity will need to measure fair value using another valuation technique (such as an income approach) or the cost to replace or recreate the asset (such as a cost approach) depending on the circumstances and the information available."

Part B: Not mandating measurement techniques to apply in fair value measurements

18. Ten ED respondents included a response to the Specific Matter for Comment (SMC) question 2 regarding the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets, including land and improvements on land subject to public-sector-specific legal restrictions:

Agree	Not completely agree/disagree	Disagree	No comment
6	3	1	6
S3–HoTARAC S9–CA & CPA S10–API S12–ACAG S14–Liquid Pacific S15–Deloitte	S2–APV[A] S5–Blacktown City Council[A,B] S11–LG Government Professionals NSW[A,B]	S4–EY[B]	S1–Cessnock City Council S6–PwC S7–KPMG S8–IPA S13–ABS S16–Tony Blefari
[A] The respondent agrees with the Board's decision to not mandate the measurement technique to apply for measuring the fair value of specific assets, but considers that the body of the guidance should include the explanation about restrictions noted in the Basis for Conclusions in ED 320 (such as paragraphs BC61, BC62, BC69, BC70). [B] The respondent was concerned that without any modifications to AASB 13, restricted land would inappropriately be measured at a value lower than the market selling price of a comparable unrestricted parcel of land.			

19. As indicated in the table above, of the 10 commenting respondents:

(a) 6 respondents agreed with the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets (refer to Section 1 below);

(b) 3 respondents, although they did not express a view about whether they agree with the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets, considered that the Board's views expressed in the Basis for Conclusion on how restrictions are considered in fair value measurement of land should be stated explicitly in the body of the Standard (refer to Section 2 below); and

(c) 1 respondent considered the Board should mandate the cost approach to be applied when measuring assets not held primarily for their ability to generate net cash inflows (refer to Section 2 below).

Section 1: The Board's considerations when developing ED 320

20. When developing ED 320 the Board "… considered that determining appropriate measurement techniques for measuring the fair value of an asset is best regarded as relating to detailed valuation assessments and should not be mandated in Australian Accounting Standards. Unless there is significant diversity in applying accounting principles in practice, there is no clear case for mandating the use of a particular valuation technique in measuring the fair value of a particular type or class of assets." (ED 320 paragraph BC165)

21. The Board made this decision after considering the following factors:

(a) AASB 13 paragraph 61 requires an entity to select measurement techniques that are appropriate in the circumstances; for which sufficient data are available to measure fair value; and that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (ED 320 paragraph BC164);

(b) despite the debate regarding fair value measurement of restricted land, feedback from most stakeholders in targeted outreach and most feedback on ITC 45 indicated that, in practice, the fair value of restricted land is being measured mainly using the market approach with adjustments to reflect restrictions (albeit different methods are being used to calculate the adjustments) (ED 320 paragraph BC 166);

(c) AASB 13 paragraph 11 states that a fair value measurement is for a particular asset; and, therefore, when measuring the fair value of an asset, the entity considers the characteristics of the asset if market participants would take those characteristics into account when pricing the asset at the measurement date, including the condition and location of the asset, as well as any restrictions that would be transferred to a market participant (ED 320 paragraph BC 167);

(d) Since the condition and location of every parcel of land are likely to differ, and the effect of public-sector-specific legal restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted and whether the land is urban, suburban or rural, the Board considered that it would neither be practical nor appropriate for Australian Accounting Standards to specify the amount of appropriate adjustments under the market approach to reflect the effect of restrictions that would transfer to market participants (ED 320 paragraph BC 169); and

(e) If the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction (ED 320 paragraph BC 170).

Section 2: Respondents' comments regarding the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets

22. Five of the 6 respondents who agreed with the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets provided their reasons for their view, as summarised below.

23. S9–CA & CPA commented that "Feedback from our members is that the nature and impact of restrictions on specific assets varies considerably and so assessing this impact is best left to the detailed valuation assessments. We agree with the commentary … that the current requirements of AASB 13 enable a largely consistent approach to measurement for affected types of asset classes."

24. **Staff observation:** The comments from S9–CA & CPA is in line with the Board's rationale noted in paragraph 20, and (a) and (b) of paragraph 21.

25. S10–API considered that "… there should be no mandate for AASB to provide guidance to Valuers on valuation standards/methodology. Guidance should be left to the Valuer to interpret the AASB Standard in line with International Valuation Standards and relevant State Treasury Policy."

26. S12–ACAG is of the view that "Specifying a specific measurement technique for measuring land and improvements on land subject to public sector legal restrictions appears to conflict (from a standard-setting perspective) with paragraph 61 of AASB 13…"

27. **Staff observation**: ACAG's comment is in line with the Board's rationale noted in (a) of paragraph 22.

28. S14–Liquid Pacific stated that "The legal, technical, and economic framework in which assets exist (all assets) is constantly evolving. The methodologies used to value assets are also evolving to meet these changes, and so we do not see how mandating measurement techniques could ensure a consistent and contemporary approach to the fair value measurement of assets for any ownership group."

29. S15–Deloitte noted that "… AASB 13 was drafted to support valuation professionals in performing fair value measurements to be used in financial reporting. We concur with the Board's observations that in developing AASB 13 (and IFRS 13 *Fair Value Measurement* on which AASB 13 is based), mandating a single valuation technique was considered but rejected on the basis that fair value measurement is for a particular asset (AASB 13 paragraph 11) and determining the appropriateness of a particular valuation technique requires judgement in each circumstance, even for similar assets (IFRS 13 paragraph BC142)."

30. **Staff observation:** Deloitte's comment above is in line with Board's rationale noted in (c) and (d) of paragraph 21.

31. S15–Deloitte also noted that "With reference to the *AASB's Not-for-Profit Entity Standard-Setting Framework*, we are not aware of any argument that would suggest the AASB should amend this principle for NFP entities in the public sector." and "The role of accounting and financial reporting should not, in our opinion, interfere with the professional expertise of valuation professionals."

32. In addition, S9–CA & CPA, S12–ACAG and S15–Deloitte also acknowledged the Board's rationale noted in paragraph 21(e) above – that, if consistency is desired, the relevant authority in each jurisdiction may choose to designate a valuation approach to apply to certain assets held by public sector entities in its jurisdiction.

33. However, S12–ACAG noted that one of its jurisdictions recommended the Board to state "…that the cost approach should be used when data that is relevant, reliable and current for the market approach is unavailable both externally and internally (and when the income approach is not appropriate because the asset is not held to generate net cash inflows)." [Staff observed that this comment appears to relate to non-financial assets other than land.]

34. S4–EY also commented that "… 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 … 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 … 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."

35. **Staff observation:** Staff observed that EY's support for mandating the cost approach is mainly related to their concerns about how restricted land is measured. Their concerns about restricted land and staff analysis thereof are included in Section 3 and Section 4 below.

Staff conclusion

36. In respect of the comment raised by that ACAG jurisdiction noted in paragraph 33 and the comment from EY, staff consider that AASB 13 paragraph 61 adequately addresses this issue without needing supporting guidance. That paragraph states that "An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available

to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs."

37. Based on the feedback from those six respondents and the Board's previous considerations in developing ED 320 noted in Section 1, in respect of fair value measurement of non-financial assets other than restricted land, staff did not identify any additional supporting or opposing arguments that had not yet been considered by the Board in deciding not to mandate the measurement technique to apply for measuring the fair value of specific assets.

Section 3: Respondents' comments on restricted land – mandating a specific measurement technique to apply

38. S4–EY requested the Board to reconsider its decision not to mandate the use of the cost approach in measuring assets that are not held primarily for their ability to generate net cash inflows, including restricted land. They made the following comments in their submission:

    (a) "the AASB should provide specific guidance to enable entities to determine appropriate measurement techniques for measuring the fair value of assets … including the fair value of land and improvements on land subject to public-sector-specific legal restrictions."

    (b) "… there is diversity … 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."

    (c) "… 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 is now used as a 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."

Staff observation

39. EY's view noted in (c) above is consistent with a minority of stakeholders' views described in ED 320 paragraphs BC158–BC159:

    BC158 The minority of stakeholders … considered that the cost approach would be the most appropriate measurement technique for measuring the fair value of restricted land where an equivalent parcel of land subject to the same public-sector-specific legal restrictions is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. They also commented that if the cost approach is applied, those public-sector-specific legal restrictions would not reduce the fair value of such restricted land to an amount less than the price of equivalent land without those restrictions ...

    BC159 Those stakeholders reached this view because they interpreted that, when applying the IASB's views in IFRS 13 paragraphs BC78–BC79:

    (a) many parcels of land might have little value if sold on a stand-alone basis (due to the restrictions), but would have a significant value to the holder of the asset (in terms of the asset’s ability to provide goods or services to beneficiaries) when used together with other non-financial assets; and

(b) the market approach might be inappropriate in measuring the land’s fair value when the market price of the land represents the use of the land on a stand-alone basis rather than in combination with complementary assets.

40. However, for the reasons noted in paragraphs 20–21 above, the Board did not form a view on whether a particular measurement technique is more appropriate than others for measuring the fair value of restricted land.

41. In contrast with S4–EY, S12–ACAG is of the view that “… public-sector-specific restrictions (whether legal or implied socio-political restrictions) should be considered when valuing land by using the market approach with an adjustment to reflect the restrictions.”

42. In addition to their comments noted in paragraph 26, ACAG commented that measuring land using the market approach with an adjustment to reflect the restrictions is consistent with the proposals in ED 320 because:

(a) “… Applying the requirements of paragraph F9 means the highest and best use of, for example, community parkland is its current use as a park (assuming this presumption cannot be rebutted) and therefore the valuation of the land should be based on its current use as a park, rather than by reference to surrounding land that may be used for residential, commercial or other uses. This is irrespective of whether or not there are legal restrictions on the use of the land as a park.”

(b) “… BC62 states that the fair value of an asset would take into account the effect of restrictions that would transfer to market participants in a hypothetical sale transaction. Paragraph 140.5 of International Valuation Standards 104 *Bases of Value* states that ‘to reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, e.g., town planning/zoning designations, need to be taken into account as well as the likelihood that these restrictions will change'. In the public sector, entities such as councils may not be able to remove zoning restrictions. For example, in NSW, community land cannot be sold by a local council unless it is converted to operational land. In most cases, councils do not have the sole ability to change the status of this land without a comprehensive planning process that requires the approval of third parties.”

(c) “… Paragraph F4(b) of the draft ED states ‘if the market selling price of an identical asset is not directly observable, the entity explicitly estimates the pricing assumptions that market participants would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.’ A market approach maximises the use of observable inputs and will usually be available even where there is no equivalent parcel of land with the same public-sector-specific restrictions in the marketplace. For example, while there may not be an equivalent parcel of land with the same zoning restrictions in the marketplace as a park being valued, there are other parcels of land that have market prices that provide a suitable reference point.”

43. S5–Blacktown City Council commented that “… When purchasing a piece of land for community purposes, once re-zoned it will be recorded based on the Valuer General’s discounted valuation. On average the valuations have been discounted by approximately 90% from the market price. If the practice of discounting was to continue, over the next 15 years … we would need to write down $1.5 billion of acquisitions to $150 million and record an operating loss of $1.35 billion.”

44. **Staff observation:** The comment from S5 confirms the Board’s observation throughout the project that how restrictions are considered in fair value measurements of land can have a significant impact on public sector entities’ financial statements.

45. S5–Blacktown City Council (as noted in paragraph 43) and S4–EY (as noted in paragraph 38(c)) are of the view that discounting the value of land to reflect public-sector-specific restrictions would lead to land value not reflecting the land's service potential.

Staff observation

46. The Board was aware of this issue in developing ED 320. ED 320 paragraph BC154 stated "Stakeholders informed the Board that the fair value of some land subject to public-sector-specific legal restrictions … has been valued at a very low amount; sometimes a nominal amount (eg $1 for some restricted land). They questioned whether measuring such restricted land at such a low value appropriately reflects the service potential of the restricted land."

47. The Board did not form a view on whether measuring such restricted land at a low amount or nominal amount would reflect the capacity of the restricted land available to provide benefits to the holder of the land (or to provide services to the community). The Board noted that the concept of service potential in the context of an asset of an NFP entity should be considered as part of the Board's project on adapting its *Conceptual Framework for Financial Reporting* (2019) for application by NFP entities, including those in the public sector.

48. S11–LG Government Professionals NSW commented that "… Currently the fair value of land controlled by NSW councils that they have categorised as 'community' land for the purposes of the NSW Local Government Act 1993, is discounted to take into account this restriction. However, this restriction in use would not transfer to market participants in a hypothetical sale transaction."

Staff observation

49. Staff collectively considered this comment from S11, the comment from S5–Blacktown City Council noted in paragraph 43 and the comments from S12–ACAG noted in paragraphs 41–42. The collective comments appear to confirm the Board's conclusion in developing ED 320 that (as noted in paragraph 21(b)):
    (a) debate about whether the market approach (with discounts) or the cost approach (without discounts) is the most appropriate measurement technique to apply for measuring restricted land continues among financial statement preparers, auditors and valuers; however
    (b) in practice, the fair value of restricted land is being measured mainly using the market approach with adjustments to reflect restrictions.

50. That is, in practice, there is some level of consistency, at least within a jurisdiction, in how restricted land is currently being measured, although some entities (such as S4–EY, S5–Blacktown City Council and S11–LG Government Professionals NSW) disagree with the current valuation practice and are concerned that the resulting land value estimates do not reflect their service potential.

Staff analysis

51. In respect of restricted land, staff consider that until the Board forms a view on:
    (a) whether measuring restricted land at a low amount or nominal amount would reflect the service capacity of the restricted land; and
    (b) whether a market-participant-based exit-price measurement basis would lead to valuations of NFP public sector assets reflecting their service potential,

    consistent with the Board's rationale noted in paragraphs 20–21, it would be inappropriate to mandate the measurement technique to apply for measuring the fair value of restricted land.

52. Staff consider that mandating the use of the cost approach would cause AASB 13 to depart from paragraph 61 of IFRS 13 and at odds with the feedback from stakeholders noted in paragraph 12 above.

53. Furthermore, as noted by the Board in ED 320 paragraph BC 170, "If the Treasury or Finance Department (or other authority) and/or the Office of Local Government in a jurisdiction desires greater consistency in the valuation approach(es) used to measure the fair value of particular types or classes of non-financial assets in a jurisdiction, it may choose to designate a valuation approach for application to those assets held by public sector entities in its jurisdiction". As mentioned in paragraph 32, three respondents acknowledged this practice [S9–CA & CPA, S12–ACAG and S15–Deloitte].

54. Based on the stakeholder comments noted above, and staff observations in Sections 2 and 3 above, staff did not identify any supporting or opposing arguments that had not yet been considered by the Board in deciding not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land.

Staff recommendation 2

55. Accordingly, staff recommend the Board confirms its proposal not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land.

Question for Board members

Q2: Do Board members agree to confirm the Board's proposal not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land? If not, please provide your alternative view and reasons for that view.

Section 4: Respondents' comments on restricted land – Adding specific guidance in the Amending Standard

56. Three respondents commented that the Board's explanations in the Basis for Conclusion (BC) on how restrictions are considered in fair value measurements should be stated explicitly in the Board's implementation guidance to be added to AASB 13 [S2–APV, S5–Blacktown City Council, S11–LG Government Professionals NSW]. The paragraphs in question are paragraphs BC61 and BC62 in ED 320, reproduced below:

Legally permissible use

BC61 Paragraph IE29 of the Illustrative Examples accompanying IFRS 13 provides the following example of legally permissible uses of a non-financial asset:

> "A donor contributes land in an otherwise developed residential area to a not-for-profit neighbourhood association. The land is currently used as a playground. The donor specifies that the land must continue to be used by the association as a playground in perpetuity. Upon review of relevant documentation (eg legal and other), the association determines that the fiduciary responsibility to meet the donor's restriction would not be transferred to market participants if the association sold the asset, ie the donor restriction on the use of the land is specific to the association. Furthermore, the association is not restricted from selling the land. Without the restriction on the use of the land by the association, the land could be used as a site for residential development. In addition, the land is subject to an easement (ie a legal right that enables a utility to run power lines across the land)."

BC62 Consistent with the IASB's analysis in the illustrative example quoted in paragraph BC61, the Board noted that the fair value measurement of an asset:

(a) would not take into account a restriction that is specific to the entity holding the asset, ie would not transfer to market participants in a hypothetical sale transaction (eg the restriction on the use of land in the IASB's example); but

> (b) would take into account the effect of restrictions that would transfer to market participants in a hypothetical sale transaction (eg the easement restriction in the IASB's example).

57. Those respondents' comments are summarised below:

    (a) S2–APV commented that unless those Board's explanations are explicitly stated in the Board's implementation guidance, "… we will still be left with significant inconsistency in interpretation and adopted practices."

    (b) S5–Blacktown City Council commented that the wording in ED 320 paragraph F9 about the asset's current use being presumed to be its highest and best use may be "… open to interpretation such that the value is to be discounted unless the asset is marked for sale. … We would therefore recommend paragraph F being further strengthened by including the contents of BC61 and BC62 … so that there is no ambiguity about the need to only take into account the restrictions that would pass from the seller to the hypothetical buyer.

    (c) S5–Blacktown City Council also recommended the Board to include in the Amending Standard two examples "… for community land which we believe should not be discounted but recorded at the market price paid or would be paid if council had to acquire it from a third-party. Specifically,

    - Land acquired at market value and converted to community land
    - Land contributed to Council as part of a development to be used for community benefit."

    (d) S11–LG Government Professionals NSW stated that "… we support the clarification in paragraph BC62 that the fair value measurement of an asset would not take into account a restriction that is specific to the entity holding the asset, i.e. would not transfer to market participants in a hypothetical sale transaction. Due to the significance of this paragraph, we propose that this guidance be included within Appendix F [FOR AASB 13] … so that it forms an integral part of the Standard."

58. In addition, S4-EY commented that "If the AASB decides not to require the cost approach for measuring the fair value of assets … 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; and
- 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."

59. **Staff observation:** In respect of EY's suggestions, the Board had contemplated whether to provide similar guidance in developing ED 320. ED 320 paragraph BC 169 stated that "Since the condition and location of every parcel of land are likely to differ, and the effect of public-sector-specific legal restrictions on fair value measurements of land might vary depending on the likelihood of the restrictions being lifted and whether the land is urban, suburban or rural, the Board considered that it would neither be practical nor appropriate for Australian Accounting Standards to specify the amount of appropriate adjustments (eg in percentage terms) under the market approach to reflect the effect of restrictions that would transfer to market participants."

Staff analysis

60. Staff observed that the principles in AASB 13 are clear from the IASB's supplementary materials (Illustrative Examples) – the fair value of an asset would take into account the effect of restrictions that would transfer to market participants in a hypothetical sale transaction, and restrictions that would not be transferred to market participants are not considered.

61. The IASB decided to include that example in question (quoted in ED 320 paragraph BC61) in supplementary supporting material rather than as part of IFRS 13. The IASB stated that its Illustrative Examples illustrate aspects of IFRS 13 but are not intended to provide interpretative guidance. Staff consider that adding such an example in the Board's implementation guidance (which will be an integral part of AASB 13) would, inappropriately, elevate the status of the IASB example above that accorded to it by the IASB. In addition, it would create a risk that readers take the example as a rule of thumb. This is because:

    (a) the IASB's conclusion that "the restriction on the use of land" would not be taken into account in the fair value measurement of the land is drawn only after "Upon review of relevant documentation (eg legal and other), the association determines that the fiduciary responsibility to meet the donor's restriction would not be transferred to market participants if the association sold the asset"; and

    (b) as noted by S12–ACAG in paragraph 42(b), that example did not include consideration of the zoning of the land and the likelihood that the zoning would change as required under IVS 104.

    Staff consider that financial statement preparers, auditors and valuers need to apply judgement based on the facts and circumstance of each asset in determining whether a restriction imposed on an asset would transfer to market participants.

Staff recommendation 3

62. Since all IASB's supporting materials, including Illustrative Examples, apply to Australian entities, there is no need to replicate the same guidance in the NFP-public-sector-specific Amending Standard. However, staff consider that it would be beneficial to add a reference to the IASB's Illustrative Examples in the Board's Amending Standard so that readers are aware of the supplementary material provided by the IASB.

63. Accordingly, staff recommend:

    (a) not reproducing the IASB's example in Paragraph IE29 of the Illustrative Examples accompanying IFRS 13 in the Board's implementation guidance, but adding a general reference to the IASB's Illustrative Examples in the rubric of the Amending Standard; and

    (b) not adding further guidance regarding how to determine the quantum of any discounts to be applied in measuring the fair value of restricted assets.

Question for Board members
Q3: Do Board members agree with the staff recommendation in paragraph 63? If not, please provide your alternative view and reasons for that view.

Part C: Other project-scope-related comments

64. When developing ED 320, as noted in BC171, the Board considered whether to provide guidance on, amongst other issues, distinguishing obsolescence from depreciation and the method of depreciation. The Board decided that further guidance is not warranted because there does not appear to be any gap or other flaw in existing pronouncements.

65. In response, S2–APV commented that distinguishing obsolescence from depreciation and the method of depreciation "… are the areas which are widely misinterpreted and deliver the most significant non-compliance and inconsistency."

66. S2–APV recommended the Board provides further guidance to clarify that:

    (a) The depreciated replacement cost (DRC) approach "… is non-compliant with AASB 13 CRC approach as the adjustment to Replacement Cost needs to be based on an allowance for obsolescence based on the key characteristics relevant to market participants and <u>not</u> an estimate of accumulated depreciation expense based on useful life and remaining useful life. Apart from general obsolescence, these are listed in paragraph 11 as well condition, location and restrictions on sale or use.

    (b) "… to ensure the correct calculation of depreciation expense, each asset needs to be disaggregated into the different 'parts' consistent with the AASB May 2015 decision with the carrying amount of each part depreciated down to the residual value over their respective remaining useful life."

    (c) "The Fair Value of the asset needs to be determined first and then depreciated over its RUL [remaining useful life] using a pattern of consumption consistent with the expected loss of relative value of the asset …" and "… the straight-line method of depreciation should only be adopted if it matches the expected pattern of consumption of the future economic benefit."

67. In addition, S12–ACAG noted that one of its jurisdictions commented that ED 320 "… does not address how to measure physical obsolescence (e.g. proportion of useful life consumed to date or condition curve) and therefore valuers will continue with divergent practices. This jurisdiction suggests including additional paragraphs for how to measure each form of obsolescence, having regard to the guidance provided by paragraph 80 of IVS 105 [Valuation Approaches and Methods]."

Staff observation

68. The Board considered the issues raised by S2–APV at its November 2021 meeting. Agenda Paper 3.3 for that meeting includes a detailed analysis of those issues. The feedback received on ED 320 did not identify any new arguments supporting or opposing the Board's conclusion that those issues are not justifiable circumstances under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require NFP-specific modifications or guidance. This is because:

    (a) those issues are not specific to NFP entities and the IASB did not provide any further guidance on those issues; and

    (b) there does not appear to be any gap or other flaw in existing pronouncements that would cause financial statements of not-for-profit public sector entities to inadequately reflect the objectives and qualitative characteristics of financial reporting or not reflect economic reality.

69. In respect of the comment raised by that ACAG jurisdiction, staff consider that since the IASB did not specify how each type of obsolescence should be measured in IFRS 13, there does not appear to be an NFP-specific reason for the Board to address this issue.

70. Paragraph 80 of IVS 105 discusses the distinction between depreciation and obsolescence, the types of obsolescence referred to in paragraph B9 of AASB 13, ‘curable’ and ‘incurable’ physical obsolescence (which was excluded from the scope of this project, as noted in paragraphs BC171(j) and BC172 of ED 320) and the two forms of functional obsolescence. However, staff consider that the guidance in paragraph 80 of IVS 105 deals with matters of detailed valuation assessments and does not belong in Australian Accounting Standards.

Staff recommendation 4

71. Accordingly, staff recommend that the Board confirms its proposal that no standard-setting action is needed regarding the abovementioned issues.

Question for Board members
Q4: Do Board members agree with the staff view that no standard-setting action is needed regarding the abovementioned issues? If not, please provide your alternative view and reasons for that view.

Appendix A: Summary of responses to the GMCs

A1. The Board included six GMCs (questions 22–27) in ED 320. Seven ED respondents included a response to one or more of those GMCs [S3–HoTARAC, S4–EY, S9–CA & CPA, S12–ACAG, S13–ABS, S14–Liquid Pacific, S15–Deloitte]. Their comments are summarised below.

GMC Question 22
Whether the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing the proposals in this Exposure Draft?

A2. Five respondents responded to this GMC, of which 4 considered that the AASB Not-for-Profit Entity Standard-Setting Framework has been applied appropriately in developing ED 320 [S3–HoTARAC, S9–CA & CPA, S12–ACAG, S15–Deloitte].

A3. However, S4–EY considered that the proposals did not go far enough to help address the current diversity in practice in fair valuing NFP public sector entity assets including the fair value of land and improvements on land subject to public-sector-specific legal restrictions. **[This issue is discussed in Part A of this paper.]**

GMC Question 23
Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?

A4. Three respondents stated that they did not identify any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals [S4–EY, S12–ACAG, S15–Deloitte].

A5. S3–HoTARAC and S12–ACAG suggested the Board to consider any GFS-related matters arising from the ABS's submission letter. S3–HoTARAC commented that any modifications to AASB 13 should align with GFS where possible.

A6. S13–ABS commented that "Any change to the existing fair value approach as currently applied under AASB 13 could carry additional costs for the ABS to prepare alternative fair value (market value equivalent) measures for assets, to retain coherence with existing valuations in GFS and the National Accounts. These costs may also be passed onto GFS data providers, as the ABS seeks a continuation of the existing measurement basis in GFS data provision. These costs would be reduced if the new valuation approach is still deemed to reflect an appropriate market value equivalent."

GMC Question 24
Whether, overall, the proposals would result in financial statements that would be useful to users?

A7. Mixed views were received on GMC 24:

(a) Four respondents noted that, subject to the Board's consideration of their responses to the Specific Matters for Comment in ED 320, they consider that, overall, the proposals would result in financial statements that would be useful to users [S3–HoTARAC, S9–CA & CPA, S12–ACAG, S15–Deloitte]. S15–Deloitte commented that this can only happen if the financial reporting professionals work closely with the valuation professionals to implement the guidance.

(b) S9–CA & CPA commented that "… the guidance addresses many issues that have been of considerable concern to public sector stakeholders implementing AASB 13 and so will be valuable in promoting consistency of implementation. This will improve clarity and understanding for users."

(c) In contrast, S14–Liquid Pacific considered that "… supporting the use of artificial fair values by ignoring market influences and the highest and best use of assets only contributes to erroneous interpretations of an entity's financial health and management performance."

(d) S4–EY commented that "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."

(e) S12–ACAG noted that one of its jurisdictions considered that the proposals while an improvement, will not prevent the differences in fair values derived by valuers associated with the measurement of physical obsolescence and valuation of land subject to public-sector-specific restrictions. S12–ACAG also noted that:

> "This jurisdiction believes that the topics addressed by the guidance (market participants, highest and best use, greenfield versus brownfield; economic obsolescence) are often the subject of conceptual debate but in its experience have not led to material differences in outcomes between valuers. However, they believe the proposals for highest and best use (current use) and market participants are likely to reduce costs by not having to search for hypothetical situations."

(f) Moreover, that ACAG jurisdiction recommended that the Board amends AASB 116 *Property, Plant and Equipment* to allow NFP public sector entities to use the 'written-down current acquisition value', which is an alternative GFS measurement model when directly observable prices for used assets are not available for measuring classes of assets measured using the revaluation model (Paragraph 8.38 of AFGSM). That ACAG jurisdiction is of the view that written-down current acquisition value can be implemented by expensing any inefficient costs from the cost of the asset at the time of construction; and, in each subsequent year:

- "recognise depreciation expense against accumulated depreciation/other obsolescence for the year;
- revalue the gross carrying value for the subsequent change in a relevant and reliable construction index;
- revalue accumulated depreciation/other obsolescence for any:
  - change in gross carrying value
  - change in estimated useful life
  - obsolescence not captured by depreciation."

GMC Question 25

Whether the proposals are in the best interests of the Australian economy?

A8. S3–HoTARAC considered that, subject to the Board's consideration of its recommendations in its submission letter, the proposals are in the best interests of the Australian economy.

A9. S9–CA & CPA commented that "We believe the guidance addresses many issues that have been of considerable concern to stakeholders implementing fair value requirements in the NFP public sector."

GMC Question 26
Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?

A10. S3–HoTARAC noted that "We expect that there may be auditing, and assurance concerns due to the interpretation and application of valuation principles and techniques used which may vary due to the judgement involved."

A11. S4–EY commented that "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." **[This issue is discussed in Part A of this paper.]**

A12. S9–CA & CPA noted that their members' feedback indicated that auditing and assurance challenges could arise from the following proposals, if the Board does not provide additional guidance:

(a) Identification of costs included in current replacement cost **[This issue is discussed in Agenda Paper 8.5]**

(b) Retrospective application **[This issue is discussed in Agenda Paper 8.6]**.

A13. S12–ACAG commented that the proposals may create auditing and assurance challenges in the following areas:

(a) Market participant assumptions – 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. **[This issue is discussed in Part A Section 2 of Agenda Paper 8.4]**.

(b) Determining whether management is committed at the measurement date to a plan to sell the asset or to use the asset for an alternative purpose **[This issue is discussed in Part A of Agenda Paper 8.3]**.

(c) Valuation challenges and divergent practices associated with measuring the unavoidable costs of removal and disposal or unwanted structures on land and disruption costs for restoring other assets **[This issue is discussed in Agenda Paper 8.5]**.

GMC Question 27
Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

A14. S12–ACAG noted that they are unable to comment on the costs and benefits of the proposals. S13–ABS noted that they are unable to provide a quantitative estimate of costs and benefits, but commented that "… any change to the existing fair value approach as currently applied under AASB 13 could carry additional costs for the ABS to prepare alternative fair value (market value equivalent) measures for assets to retain coherence with existing valuations in GFS and the National Accounts. These costs may also be passed onto GFS data providers, as the ABS seeks a continuation of the existing measurement basis in GFS data provision, unless the new valuations are still deemed by the ABS to reflect an appropriate market value equivalent."

A15. S9–CA & CPA commented that "In our view the proposals will provide greater clarity on key implementation requirements of AASB 13 in the NFP public sector, reducing the implementation costs associated with complying with this standard.