Compiled AASB Standard **AASB 13**

Fair Value Measurement

This compiled Standard applies to annual periods beginning on or after 1 January 2024. Earlier application is permitted for annual periods beginning after 24 July 2014 but before 1 January 2024. It incorporates relevant amendments made up to and including 15 December 2022.

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AVAILABLE ON THE AASB WEBSITE

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Basis for Conclusions on IFRS 13

Australian Accounting Standard AASB 13 *Fair Value Measurement* (as amended) is set out in paragraphs 1 – Aus99.2 and Appendices A – C, E and F. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. AASB 13 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation of Standards*, which identifies the Australian Accounting Interpretations, and AASB 1057 *Application of Australian Accounting Standards*. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

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Comparison with IFRS 13

AASB 13 *Fair Value Measurement* as amended incorporates IFRS 13 *Fair Value Measurement* as issued and amended by the International Accounting Standards Board (IASB). Australian-specific paragraphs (which are not included in IFRS 13) are identified with the prefix "Aus". Paragraphs that apply only to not-for-profit entities begin by identifying their limited applicability.

Tier 1

For-profit entities complying with AASB 13 also comply with IFRS 13.

Not-for-profit entities' compliance with IFRS 13 will depend on whether any "Aus" paragraphs that specifically apply to not-for-profit entities provide additional guidance or contain applicable requirements that are inconsistent with IFRS 13.

Tier 2

Entities preparing general purpose financial statements under Australian Accounting Standards – Simplified Disclosures (Tier 2) will not be in compliance with IFRS Standards.

AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of reporting requirements.

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Accounting Standard AASB 13

The Australian Accounting Standards Board made Accounting Standard AASB 13 *Fair Value Measurement* under section 334 of the *Corporations Act 2001* on 7 August 2015.

This compiled version of AASB 13 applies to annual periods beginning on or after 1 January 2024. It incorporates relevant amendments contained in other AASB Standards made by the AASB up to and including 15 December 2022 (see Compilation Details).

Accounting Standard AASB 13 *Fair Value Measurement*

Objective

1 **This Standard:**

- **(a) defines *fair value*;**
- **(b) sets out in a single Standard a framework for measuring fair value; and**
- **(c) requires disclosures about fair value measurements.**

2 Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions (ie an *exit price* at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

3 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant *observable inputs* and minimises the use of *unobservable inputs*. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

4 The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Standard shall be applied to an entity's own equity instruments measured at fair value.

Scope

5 **This Standard applies when another Standard requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except as specified in paragraphs 6 and 7.**

6 The measurement and disclosure requirements of this Standard do not apply to the following:

- (a) share-based payment transactions within the scope of AASB 2 *Share-based Payment*;
- (b) leasing transactions accounted for in accordance with AASB 16 *Leases*; and
- (c) measurements that have some similarities to fair value but are not fair value, such as net realisable value in AASB 102 *Inventories* or value in use in AASB 136 *Impairment of Assets*.

7 The disclosures required by this Standard are not required for the following:

- (a) plan assets measured at fair value in accordance with AASB 119 *Employee Benefits*;
- (b) [deleted by the AASB]
- (c) assets for which recoverable amount is fair value less costs of disposal in accordance with AASB 136.

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8 The fair value measurement framework described in this Standard applies to both initial and subsequent measurement if fair value is required or permitted by other Australian Accounting Standards.

Measurement

Definition of fair value

9 This Standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

10 Paragraph B2 describes the overall fair value measurement approach.

The asset or liability

11 A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

(a) the condition and location of the asset; and

(b) restrictions, if any, on the sale or use of the asset.

12 The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.

13 The asset or liability measured at fair value might be either of the following:

(a) a stand-alone asset or liability (eg a financial instrument or a non-financial asset); or

(b) a group of assets, a group of liabilities or a group of assets and liabilities (eg a cash-generating unit or a business).

14 Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset or liability shall be determined in accordance with the Standard that requires or permits the fair value measurement, except as provided in this Standard.

The transaction

15 A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

16 A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(a) in the *principal market* for the asset or liability; or

(b) in the absence of a principal market, in the *most advantageous market* for the asset or liability.

17 An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

18 If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

19 The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and businesses within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and businesses within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.

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20 Although an entity must be able to access the market, the entity does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.

21 Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

Market participants

22 An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

23 In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:

(a) the asset or liability;

(b) the principal (or most advantageous) market for the asset or liability; and

(c) market participants with whom the entity would enter into a transaction in that market.

The price

24 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.

25 The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in accordance with other Australian Accounting Standards. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the asset or liability.

26 Transaction costs do not include *transport costs*. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

Application to non-financial assets

Highest and best use for non-financial assets

27 A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its *highest and best use* or by selling it to another market participant that would use the asset in its highest and best use.

28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

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Aus28.1 Notwithstanding paragraph 28(c), for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, an asset's use is financially feasible if market participants (including, but not limited to, other not-for-profit public sector entities) would be willing to invest in the asset's service capacity, considering both the capability of the asset to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services.

29 Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

Aus29.1 Notwithstanding paragraph 29, a not-for-profit public sector entity is required to consider whether, for a non-financial asset not held primarily for its ability to generate net cash inflows, the asset's highest and best use differs from its current use only when, at the measurement date, it is:

(a) classified as held for sale or held for distribution to owners in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*; or

(b) highly probable that the asset will be used for an alternative purpose to its current use, in accordance with paragraph Aus29.2.

Aus29.2 For the purposes of paragraph Aus29.1(b), it is highly probable that the asset will be used for an alternative purpose to its current use when, at the measurement date, all the following conditions are met:

(a) the alternative purpose for the asset is physically possible, legally permissible and financially feasible in accordance with paragraphs 28 and Aus28.1;

(b) the appropriate level of management is committed to a plan to change the use of the asset to that alternative purpose, and an active programme to complete the plan has been initiated;

(c) any approvals required to change the asset's use have been obtained; and

(d) based on reasonably available information, it is highly probable that the current use of the asset will cease under the plan within one year.

30 To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. For example, that might be the case for an acquired intangible asset that the entity plans to use defensively by preventing others from using it. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

Valuation premise for non-financial assets

31 The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, as follows:

(a) The highest and best use of a non-financial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business).

(i) If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (ie its complementary assets and the associated liabilities) would be available to market participants.

(ii) Liabilities associated with the asset and with the complementary assets include liabilities that fund working capital, but do not include liabilities used to fund assets other than those within the group of assets.

(iii) Assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.

(b) The highest and best use of a non-financial asset might provide maximum value to market participants on a stand-alone basis. If the highest and best use of the asset is to use it on a stand-

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alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.

32 The fair value measurement of a non-financial asset assumes that the asset is sold consistently with the unit of account specified in other Australian Accounting Standards (which may be an individual asset). That is the case even when that fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities because a fair value measurement assumes that the market participant already holds the complementary assets and the associated liabilities.

33 Paragraph B3 describes the application of the valuation premise concept for non-financial assets.

Application to liabilities and an entity's own equity instruments

General principles

34 A fair value measurement assumes that a financial or non-financial liability or an entity's own equity instrument (eg equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date. The transfer of a liability or an entity's own equity instrument assumes the following:

(a) A liability would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

(b) An entity's own equity instrument would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

35 Even when there is no observable market to provide pricing information about the transfer of a liability or an entity's own equity instrument (eg because contractual or other legal restrictions prevent the transfer of such items), there might be an observable market for such items if they are held by other parties as assets (eg a corporate bond or a call option on an entity's shares).

36 In all cases, an entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs to meet the objective of a fair value measurement, which is to estimate the price at which an orderly transaction to transfer the liability or equity instrument would take place between market participants at the measurement date under current market conditions.

Liabilities and equity instruments held by other parties as assets

37 When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.

38 In such cases, an entity shall measure the fair value of the liability or equity instrument as follows:

(a) using the quoted price in an *active market* for the identical item held by another party as an asset, if that price is available.

(b) if that price is not available, using other observable inputs, such as the quoted price in a market that is not active for the identical item held by another party as an asset.

(c) if the observable prices in (a) and (b) are not available, using another valuation technique, such as:

(i) an *income approach* (eg a present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the liability or equity instrument as an asset; see paragraphs B10 and B11).

(ii) a *market approach* (eg using quoted prices for similar liabilities or equity instruments held by other parties as assets; see paragraphs B5–B7).

39 An entity shall adjust the quoted price of a liability or an entity's own equity instrument held by another party as an asset only if there are factors specific to the asset that are not applicable to the fair value measurement of the liability or equity instrument. An entity shall ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset. Some factors that may indicate that the quoted price of the asset should be adjusted include the following:

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(a) The quoted price for the asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset. For example, the liability or equity instrument may have a particular characteristic (eg the credit quality of the issuer) that is different from that reflected in the fair value of the similar liability or equity instrument held as an asset.

(b) The unit of account for the asset is not the same as for the liability or equity instrument. For example, for liabilities, in some cases the price for an asset reflects a combined price for a package comprising both the amounts due from the issuer and a third-party credit enhancement. If the unit of account for the liability is not for the combined package, the objective is to measure the fair value of the issuer's liability, not the fair value of the combined package. Thus, in such cases, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement.

Liabilities and equity instruments not held by other parties as assets

40 When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is not held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

41 For example, when applying a present value technique an entity might take into account either of the following:

(a) the future cash outflows that a market participant would expect to incur in fulfilling the obligation, including the compensation that a market participant would require for taking on the obligation (see paragraphs B31–B33).

(b) the amount that a market participant would receive to enter into or issue an identical liability or equity instrument, using the assumptions that market participants would use when pricing the identical item (eg having the same credit characteristics) in the principal (or most advantageous) market for issuing a liability or an equity instrument with the same contractual terms.

Non-performance risk

42 The fair value of a liability reflects the effect of *non-performance risk*. Non-performance risk includes, but may not be limited to, an entity's own credit risk (as defined in AASB 7 *Financial Instruments: Disclosures*). Non-performance risk is assumed to be the same before and after the transfer of the liability.

43 When measuring the fair value of a liability, an entity shall take into account the effect of its credit risk (credit standing) and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:

(a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability).

(b) the terms of credit enhancements related to the liability, if any.

44 The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account. The issuer of a liability issued with an inseparable third-party credit enhancement that is accounted for separately from the liability shall not include the effect of the credit enhancement (eg a third-party guarantee of debt) in the fair value measurement of the liability. If the credit enhancement is accounted for separately from the liability, the issuer would take into account its own credit standing and not that of the third party guarantor when measuring the fair value of the liability.

Restriction preventing the transfer of a liability or an entity's own equity instrument

45 When measuring the fair value of a liability or an entity's own equity instrument, an entity shall not include a separate input or an adjustment to other *inputs* relating to the existence of a restriction that prevents the transfer of the item. The effect of a restriction that prevents the transfer of a liability or an entity's own equity instrument is either implicitly or explicitly included in the other inputs to the fair value measurement.

46 For example, at the transaction date, both the creditor and the obligor accepted the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer. As a result of the restriction being included in the transaction price, a separate input or an adjustment to an existing input is not required at the transaction date to reflect the effect of the restriction on transfer. Similarly, a separate

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input or an adjustment to an existing input is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.

Financial liability with a demand feature

47 The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

48 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (as defined in AASB 7) and to the credit risk (as defined in AASB 7) of each of the counterparties. If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this Standard for measuring fair value. That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

49 An entity is permitted to use the exception in paragraph 48 only if the entity does all the following:

(a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy;

(b) provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as defined in AASB 124 *Related Party Disclosures*; and

(c) is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

50 The exception in paragraph 48 does not pertain to financial statement presentation. In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if a Standard does not require or permit financial instruments to be presented on a net basis. In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53–56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure. An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

51 An entity shall make an accounting policy decision in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to use the exception in paragraph 48. An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs 53–55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio.

52 The exception in paragraph 48 applies only to financial assets, financial liabilities and other contracts within the scope of AASB 9 *Financial Instruments* (or AASB 139 *Financial Instruments: Recognition and Measurement*, if AASB 9 has not yet been adopted). The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, AASB 9 (or AASB 139, if AASB 9 has not yet been adopted), regardless of whether they meet the definitions of financial assets or financial liabilities in AASB 132 *Financial Instruments: Presentation*.

Exposure to market risks

53 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities managed on the basis of the entity's net exposure to a particular market risk (or risks), the entity shall apply the price within the bid-ask spread that is most representative of fair value in the circumstances to the entity's net exposure to those market risks (see paragraphs 70 and 71).

54 When using the exception in paragraph 48, an entity shall ensure that the market risk (or risks) to which the entity is exposed within that group of financial assets and financial liabilities is substantially the same. For example, an entity would not combine the interest rate risk associated with a financial asset with the

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commodity price risk associated with a financial liability because doing so would not mitigate the entity's exposure to interest rate risk or commodity price risk. When using the exception in paragraph 48, any basis risk resulting from the market risk parameters not being identical shall be taken into account in the fair value measurement of the financial assets and financial liabilities within the group.

55 Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities shall be substantially the same. For example, an entity that uses a 12-month futures contract against the cash flows associated with 12 months' worth of interest rate risk exposure on a five-year financial instrument within a group made up of only those financial assets and financial liabilities measures the fair value of the exposure to 12-month interest rate risk on a net basis and the remaining interest rate risk exposure (ie years 2–5) on a gross basis.

Exposure to the credit risk of a particular counterparty

56 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities entered into with a particular counterparty, the entity shall include the effect of the entity's net exposure to the credit risk of that counterparty or the counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default (eg a master netting agreement with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party). The fair value measurement shall reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

Fair value at initial recognition

57 When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

58 In many cases the transaction price will equal the fair value (eg that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).

59 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph B4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.

60 If another Standard requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that Standard specifies otherwise.

Valuation techniques

61 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.

62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the *cost approach* and the income approach. The main aspects of those approaches are summarised in paragraphs B5–B11. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.

63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

64 If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated

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so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset or liability) at the measurement date.

65 Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (eg a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:

(a) new markets develop;

(b) new information becomes available;

(c) information previously used is no longer available;

(d) valuation techniques improve; or

(e) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with AASB 108. However, the disclosures in AASB 108 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to valuation techniques

General principles

67 Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

68 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include exchange markets, dealer markets, brokered markets and principal-to-principal markets (see paragraph B34).

69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs 11 and 12). In some cases those characteristics result in the application of an adjustment, such as a premium or discount (eg a control premium or non-controlling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the Standard that requires or permits the fair value measurement (see paragraphs 13 and 14). Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 80) rather than as a characteristic of the asset or liability (eg a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in an active market (ie a *Level 1 input*) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph 79.

Inputs based on bid and ask prices

70 If an asset or a liability measured at fair value has a bid price and an ask price (eg an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (ie Level 1, 2 or 3; see paragraphs 72–90). The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required.

71 This Standard does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

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Fair value hierarchy

72 To increase consistency and comparability in fair value measurements and related disclosures, this Standard establishes a fair value hierarchy that categorises into three levels (see paragraphs 76–90) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (*Level 3 inputs*).

73 In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value, such as costs to sell when measuring fair value less costs to sell, shall not be taken into account when determining the level of the fair value hierarchy within which a fair value measurement is categorised.

74 The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph 61). However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorised within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorised.

75 If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorised within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a *Level 2 input* and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorised within Level 3 of the fair value hierarchy.

Level 1 inputs

76 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.

78 A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (eg on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

(a) the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and

(b) whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

79 An entity shall not make an adjustment to a Level 1 input except in the following circumstances:

(a) when an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (ie given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(b) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.

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(c) when measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph 39). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorised within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorised within a lower level of the fair value hierarchy.

80 If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 inputs

81 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

82 If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability, for example:

(i) interest rates and yield curves observable at commonly quoted intervals;

(ii) implied volatilities; and

(iii) credit spreads.

(d) *market-corroborated inputs.*

83 Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

(a) the condition or location of the asset;

(b) the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 39); and

(c) the volume or level of activity in the markets within which the inputs are observed.

84 An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

85 Paragraph B35 describes the use of Level 2 inputs for particular assets and liabilities.

Level 3 inputs

86 Level 3 inputs are unobservable inputs for the asset or liability.

87 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. However, the fair value measurement objective remains the same, ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

88 Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (eg when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value, as described in paragraphs B37–B47).

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89 An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. 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). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

90 Paragraph B36 describes the use of Level 3 inputs for particular assets and liabilities.

Disclosure

91 An entity shall disclose information that helps users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

92 To meet the objectives in paragraph 91, an entity shall consider all the following:

(a) the level of detail necessary to satisfy the disclosure requirements;

(b) how much emphasis to place on each of the various requirements;

(c) how much aggregation or disaggregation to undertake; and

(d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this Standard and other Australian Accounting Standards are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Standard) in the statement of financial position after initial recognition:

(a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fair value measurements of assets or liabilities are those that other Australian Accounting Standards require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other Australian Accounting Standards require or permit in the statement of financial position in particular circumstances (eg when an entity measures an asset held for sale at fair value less costs to sell in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* because the asset's fair value less costs to sell is lower than its carrying amount).

(b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(c) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

(d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative

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information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

(e) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

(i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.

(ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

(iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).

(iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(f) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(g) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).

(h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

(i) for all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with (d).

(ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

Aus93.1 Notwithstanding paragraph 93, in respect of not-for-profit public sector entities, for assets within the scope of AASB 116 *Property, Plant and Equipment* for which the future economic benefits are not primarily dependent on the asset's ability to generate net cash inflows, the following requirements do not apply:

(a) in paragraph 93(d), the text "For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the

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significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.";

(b) paragraph 93(f); and

(c) paragraph 93(h)(i).

Aus93.2 For a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the information in paragraph 93(i) is required to be disclosed only if the entity has determined that the asset's highest and best use differs from its current use. Such an entity is required to consider whether this difference exists only when, in accordance with paragraphs Aus29.1 and Aus29.2, at the measurement date, the asset is classified as held for sale or held for distribution to owners in accordance with AASB 5 or it is highly probable that the asset will be used for an alternative purpose to its current use.

94 An entity shall determine appropriate classes of assets and liabilities on the basis of the following:

(a) the nature, characteristics and risks of the asset or liability; and

(b) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another Standard specifies the class for an asset or a liability, an entity may use that class in providing the disclosures required in this Standard if that class meets the requirements in this paragraph.

95 An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph 93(c) and (e)(iv). The policy about the timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:

(a) the date of the event or change in circumstances that caused the transfer.

(b) the beginning of the reporting period.

(c) the end of the reporting period.

96 If an entity makes an accounting policy decision to use the exception in paragraph 48, it shall disclose that fact.

97 For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this Standard.

98 For a liability measured at fair value and issued with an inseparable third-party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.

99 An entity shall present the quantitative disclosures required by this Standard in a tabular format unless another format is more appropriate.

Commencement of the legislative instrument

Aus99.1 [Repealed]

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Withdrawal of AASB pronouncements

Aus99.2 This Standard repeals AASB 13 *Fair Value Measurement* issued in September 2011. Despite the repeal, after the time this Standard starts to apply under section 334 of the Corporations Act (either generally or in relation to an individual entity), the repealed Standard continues to apply in relation to any period ending before that time as if the repeal had not occurred.

[Note: When this Standard applies under section 334 of the Corporations Act (either generally or in relation to an individual entity), it supersedes the application of the repealed Standard.]

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Appendix A
Defined terms

This appendix is an integral part of the Standard.

active market A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

cost approach A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

entry price The price paid to acquire an asset or received to assume a liability in an exchange transaction.

exit price The price that would be received to sell an asset or paid to transfer a liability.

expected cash flow The probability-weighted average (ie mean of the distribution) of possible future cash flows.

fair value The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

highest and best use The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.

income approach Valuation techniques that convert future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

inputs The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following:

(a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and

(b) the risk inherent in the inputs to the valuation technique.

Inputs may be observable or unobservable.

Level 1 inputs Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs Unobservable inputs for the asset or liability.

market approach A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.

market-corroborated inputs Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

market participant Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

(a) They are independent of each other, ie they are not related parties as defined in AASB 124, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

(b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.

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(c) They are able to enter into a transaction for the asset or liability.

(d) They are willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.

most advantageous market The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

non-performance risk The risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.

observable inputs Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.

orderly transaction A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).

principal market The market with the greatest volume and level of activity for the asset or liability.

risk premium Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.

transaction costs The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:

(a) They result directly from and are essential to that transaction.

(b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made (similar to costs to sell, as defined in AASB 5).

transport costs The costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.

unit of account The level at which an asset or a liability is aggregated or disaggregated in a Standard for recognition purposes.

unobservable inputs 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.

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Appendix B
Application guidance

This appendix is an integral part of the Standard. It describes the application of paragraphs 1–99 and has the same authority as the other parts of the Standard.

B1 The judgements applied in different valuation situations may be different. This appendix describes the judgements that might apply when an entity measures fair value in different valuation situations.

The fair value measurement approach

B2 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:

(a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).

(b) for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).

(c) the principal (or most advantageous) market for the asset or liability.

(d) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Valuation premise for non-financial assets (paragraphs 31–33)

B3 When measuring the fair value of a non-financial asset used in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business), the effect of the valuation premise depends on the circumstances. For example:

(a) the fair value of the asset might be the same whether the asset is used on a stand-alone basis or in combination with other assets or with other assets and liabilities. That might be the case if the asset is a business that market participants would continue to operate. In that case, the transaction would involve valuing the business in its entirety. The use of the assets as a group in an ongoing business would generate synergies that would be available to market participants (ie market participant synergies that, therefore, should affect the fair value of the asset on either a stand-alone basis or in combination with other assets or with other assets and liabilities).

(b) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through adjustments to the value of the asset used on a stand-alone basis That might be the case if the asset is a machine and the fair value measurement is determined using an observed price for a similar machine (not installed or otherwise configured for use), adjusted for transport and installation costs so that the fair value measurement reflects the current condition and location of the machine (installed and configured for use).

(c) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through the market participant assumptions used to measure the fair value of the asset. For example, if the asset is work in progress inventory that is unique and market participants would convert the inventory into finished goods, the fair value of the inventory would assume that market participants have acquired or would acquire any specialised machinery necessary to convert the inventory into finished goods.

(d) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the valuation technique used to measure the fair value of the asset. That might be the case when using the multi-period excess earnings method to measure the fair value of an intangible asset because that valuation technique specifically takes into account the contribution of any complementary assets and the associated liabilities in the group in which such an intangible asset would be used.

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(e) in more limited situations, when an entity uses an asset within a group of assets, the entity might measure the asset at an amount that approximates its fair value when allocating the fair value of the asset group to the individual assets of the group. That might be the case if the valuation involves real property and the fair value of improved property (ie an asset group) is allocated to its component assets (such as land and improvements).

Fair value at initial recognition (paragraphs 57–60)

B4 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

(a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

(b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

(c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another Standard, or the transaction price includes transaction costs.

(d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

Valuation techniques (paragraphs 61–66)

Market approach

B5 The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.

B6 For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

B7 Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

Cost approach

B8 The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

B9 From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

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Income approach

B10 The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

B11 Those valuation techniques include, for example, the following:

(a) present value techniques (see paragraphs B12–B30);

(b) option pricing models, such as the Black-Scholes-Merton formula or a binomial model (ie a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and

(c) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

Present value techniques

B12 Paragraphs B13–B30 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an *expected cash flow* (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (eg whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

The components of a present value measurement

B13 Present value (ie an application of the income approach) is a tool used to link future amounts (eg cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

(a) an estimate of future cash flows for the asset or liability being measured.

(b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.

(c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (ie a risk-free interest rate).

(d) the price for bearing the uncertainty inherent in the cash flows (ie a *risk premium*).

(e) other factors that market participants would take into account in the circumstances.

(f) for a liability, the non-performance risk relating to that liability, including the entity's (ie the obligor's) own credit risk.

General principles

B14 Present value techniques differ in how they capture the elements in paragraph B13. However, all the following general principles govern the application of any present value technique used to measure fair value:

(a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.

(b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.

(c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (ie a discount rate adjustment technique). That same rate should not be used if using expected (ie probability-weighted) cash flows (ie an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in

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future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.

(d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.

(e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

Risk and uncertainty

B15 A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is risk of default.

B16 Market participants generally seek compensation (ie a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.

B17 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

(a) The discount rate adjustment technique (see paragraphs B18–B22) uses a risk-adjusted discount rate and contractual, promised or most likely cash flows.

(b) Method 1 of the expected present value technique (see paragraph B25) uses risk-adjusted expected cash flows and a risk-free rate.

(c) Method 2 of the expected present value technique (see paragraph B26) uses expected cash flows that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. That rate is different from the rate used in the discount rate adjustment technique.

Discount rate adjustment technique

B18 The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (eg contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (ie a market rate of return).

B19 The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (eg whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (eg credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (ie using a 'build-up' approach).

B20 To illustrate a build-up approach, assume that Asset A is a contractual right to receive CU800[1] in one year (ie there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

1 In this Standard monetary amounts are denominated in 'currency units (CU)'.

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(a) Asset B is a contractual right to receive CU1,200 in one year and has a market price of CU1,083. Thus, the implied annual rate of return (ie a one-year market rate of return) is 10.8 per cent [(CU1,200/CU1,083) – 1].

(b) Asset C is a contractual right to receive CU700 in two years and has a market price of CU566. Thus, the implied annual rate of return (ie a two-year market rate of return) is 11.2 per cent [$(CU700/CU566)^{0.5}$ – 1].

(c) All three assets are comparable with respect to risk (ie dispersion of possible pay-offs and credit).

B21 On the basis of the timing of the contractual payments to be received for Asset A relative to the timing for Asset B and Asset C (ie one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (CU800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is CU722 (CU800/1.108). Alternatively, in the absence of available market information for Asset B, the one-year market rate could be derived from Asset C using the build-up approach. In that case the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

B22 When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

Expected present value technique

B23 The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (ie the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).

B24 In making an investment decision, risk-averse market participants would take into account the risk that the actual cash flows may differ from the expected cash flows. Portfolio theory distinguishes between two types of risk:

(a) unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.

(b) systematic (non-diversifiable) risk, which is the common risk shared by an asset or a liability with the other items in a diversified portfolio.

Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

B25 Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (ie market) risk by subtracting a cash risk premium (ie risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of CU1,200 for a certain cash flow of CU1,000, the CU1,000 is the certainty equivalent of the CU1,200 (ie the CU200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.

B26 In contrast, Method 2 of the expected present value technique adjusts for systematic (ie market) risk by applying a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows (ie an expected rate of return). Models used for pricing risky assets, such as the capital asset pricing model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.

B27 To illustrate Methods 1 and 2, assume that an asset has expected cash flows of CU780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free

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interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	Probability	Probability-weighted cash flows
CU500	15%	CU75
CU800	60%	CU480
CU900	25%	CU225
Expected cash flows		CU780

B28 In this simple illustration, the expected cash flows (CU780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realised cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (eg changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.

B29 In theory, the present value (ie the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:

(a) Using Method 1, the expected cash flows are adjusted for systematic (ie market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (ie the cash risk premium of CU22) could be determined using the systematic risk premium of 3 per cent (CU780 – [CU780 × (1.05/1.08)]), which results in risk-adjusted expected cash flows of CU758 (CU780 – CU22). The CU758 is the certainty equivalent of CU780 and is discounted at the risk-free interest rate (5 per cent). The present value (ie the fair value) of the asset is CU722 (CU758/1.05).

(b) Using Method 2, the expected cash flows are not adjusted for systematic (ie market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (ie the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (ie the fair value) of the asset is CU722 (CU780/1.08).

B30 When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

Applying present value techniques to liabilities and an entity's own equity instruments not held by other parties as assets (paragraphs 40 and 41)

B31 When using a present value technique to measure the fair value of a liability that is not held by another party as an asset (eg a decommissioning liability), an entity shall, among other things, estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation. Those future cash outflows shall include market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation. Such compensation includes the return that a market participant would require for the following:

(a) undertaking the activity (ie the value of fulfilling the obligation; eg by using resources that could be used for other activities); and

(b) assuming the risk associated with the obligation (ie a risk premium that reflects the risk that the actual cash outflows might differ from the expected cash outflows; see paragraph B33).

B32 For example, a non-financial liability does not contain a contractual rate of return and there is no observable market yield for that liability. In some cases the components of the return that market participants would

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require will be indistinguishable from one another (eg when using the price a third party contractor would charge on a fixed fee basis). In other cases an entity needs to estimate those components separately (eg when using the price a third party contractor would charge on a cost plus basis because the contractor in that case would not bear the risk of future changes in costs).

B33 An entity can include a risk premium in the fair value measurement of a liability or an entity's own equity instrument that is not held by another party as an asset in one of the following ways:

(a) by adjusting the cash flows (ie as an increase in the amount of cash outflows); or

(b) by adjusting the rate used to discount the future cash flows to their present values (ie as a reduction in the discount rate).

An entity shall ensure that it does not double-count or omit adjustments for risk. For example, if the estimated cash flows are increased to take into account the compensation for assuming the risk associated with the obligation, the discount rate should not be adjusted to reflect that risk.

Inputs to valuation techniques (paragraphs 67–71)

B34 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include the following:

(a) *Exchange markets.* In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the London Stock Exchange.

(b) *Dealer markets.* In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (eg used equipment).

(c) *Brokered markets.* In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.

(d) *Principal-to-principal markets.* In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

Fair value hierarchy (paragraphs 72–90)

Level 2 inputs (paragraphs 81–85)

B35 Examples of Level 2 inputs for particular assets and liabilities include the following:

(a) *Receive-fixed, pay-variable interest rate swap based on the London Interbank Offered Rate (LIBOR) swap rate.* A Level 2 input would be the LIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.

(b) *Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency.* A Level 2 input would be the swap rate based on a yield curve denominated in a foreign currency that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety.

(c) *Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate.* A Level 2 input would be the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, for example, by correlation with an interest rate that is observable over substantially the full term of the swap.

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(d) *Three-year option on exchange-traded shares.* A Level 2 input would be the implied volatility for the shares derived through extrapolation to year 3 if both of the following conditions exist:

  (i) Prices for one-year and two-year options on the shares are observable.

  (ii) The extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option.

  In that case the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.

(e) *Licensing arrangement.* For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.

(f) *Finished goods inventory at a retail outlet.* For finished goods inventory that is acquired in a business combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (ie similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.

(g) *Building held and used.* A Level 2 input would be the price per square metre for the building (a valuation multiple) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) buildings in similar locations.

(h) *Cash-generating unit.* A Level 2 input would be a valuation multiple (eg a multiple of earnings or revenue or a similar performance measure) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) businesses, taking into account operational, market, financial and non-financial factors.

Level 3 inputs (paragraphs 86–90)

B36 Examples of Level 3 inputs for particular assets and liabilities include the following:

(a) *Long-dated currency swap.* A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.

(b) *Three-year option on exchange-traded shares*. A Level 3 input would be historical volatility, ie the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.

(c) *Interest rate swap.* A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.

(d) *Decommissioning liability assumed in a business combination.* A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfil the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, eg a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.

(e) *Cash-generating unit.* A Level 3 input would be a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

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Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

B37 The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following:

(a) There are few recent transactions.

(b) Price quotations are not developed using current information.

(c) Price quotations vary substantially either over time or among market-makers (eg some brokered markets).

(d) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.

(e) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.

(f) There is a wide bid-ask spread or significant increase in the bid-ask spread.

(g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (ie a primary market) for the asset or liability or similar assets or liabilities.

(h) Little information is publicly available (eg for transactions that take place in a principal-to-principal market).

B38 If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

B39 This Standard does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs 61–66 and B5–B11 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.

B40 If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

B41 Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (ie not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.

B42 Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. An entity's intention to hold the asset or to settle or otherwise fulfil the liability is

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not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.

Identifying transactions that are not orderly

B43 The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (ie forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

(a) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.

(b) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.

(c) The seller is in or near bankruptcy or receivership (ie the seller is distressed).

(d) The seller was required to sell to meet regulatory or legal requirements (ie the seller was forced).

(e) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

B44 An entity shall consider all the following when measuring fair value or estimating market risk premiums:

(a) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.

(b) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:

(i) the volume of the transaction.

(ii) the comparability of the transaction to the asset or liability being measured.

(iii) the proximity of the transaction to the measurement date.

(c) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (ie the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

Using quoted prices provided by third parties

B45 This Standard does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this Standard.

B46 If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.

B47 Furthermore, the nature of a quote (eg whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.

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Appendix C
Effective date and transition

This appendix is an integral part of the Standard and has the same authority as the other parts of the Standard.

C1 An entity shall apply this Standard for annual periods beginning on or after 1 January 2018. Earlier application is permitted for periods beginning after 24 July 2014 but before 1 January 2018. If an entity applies this Standard for an earlier period, it shall disclose that fact.

AusC1.1 Paragraphs C2 and C3 shall not be applied by an entity that has previously applied AASB 13, unless required to do so by another Standard.

C2 This Standard shall be applied prospectively as of the beginning of the annual period in which it is initially applied.

C3 The disclosure requirements of this Standard need not be applied in comparative information provided for periods before initial application of this Standard.

C4 [Deleted by the AASB]

C5 AASB 2014-7 *Amendments to Australian Accounting Standards arising from AASB 9 (December 2014)*, issued in December 2014, amended paragraph 52 in the previous version of this Standard. An entity shall apply that amendment when it applies AASB 9.

C6 AASB 16 *Leases*, issued in February 2016, amended paragraph 6. An entity shall apply that amendment when it applies AASB 16.

AusC6.1 AASB 2022-10 *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* amended AASB 13 for application by not-for-profit public sector entities, including adding Appendix F *Australian implementation guidance for not-for-profit public sector entities*. A not-for-profit public sector entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2024. Earlier application is permitted. If an entity applies AASB 2022-10 for an earlier period, it shall disclose that fact.

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Appendix E
Australian simplified disclosures for Tier 2 entities

This appendix is an integral part of the Standard.

AusE1 **Paragraphs 91–99 do not apply to entities preparing general purpose financial statements that apply AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities.***

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Appendix F
Australian implementation guidance for not-for-profit public sector entities

This appendix is an integral part of the Standard. It describes the application of paragraphs 61, 62, 89, B8 and B9 of the Standard. The appendix applies only to not-for-profit public sector entities.

Introduction

F1 AASB 13 *Fair Value Measurement* incorporates International Financial Reporting Standard IFRS 13 *Fair Value Measurement*, issued by the International Accounting Standards Board. Consequently, the text of AASB 13 is generally expressed from the perspective of for-profit entities. The AASB prepared this appendix to explain and illustrate the application of the principles of paragraphs 61, 62, 89, B8 and B9 of the Standard by not-for-profit public sector entities in relation to fair value measurement of non-financial assets not held primarily for their ability to generate net cash inflows. This appendix does not apply to for-profit entities or not-for-profit private sector entities or affect their application of AASB 13.

Developing unobservable inputs (paragraphs 61, 62 and 89)

F2 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.

F3 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:

(a) 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); and

(b) need not undertake exhaustive efforts to obtain information about market participant assumptions.

F4 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 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.

F5 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 both the market selling price of a comparable asset and some market participant data required to measure the fair value of the asset are not observable, the entity shall use its own assumptions as a starting point in developing unobservable inputs and adjust those assumptions to the extent that reasonably available information indicates that other market participants (including, but not limited to, other not-for-profit public sector entities) would use different data.

F6 For the purposes of paragraph F5, 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. To the extent that relevant information about other market participant assumptions is not reasonably available, the entity shall use its own assumptions in measuring the fair value of the asset.

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F7 For the purposes of paragraphs F5 and F6, for assets with various inputs to their fair value estimate, observable market data might be reasonably available for some inputs, in which instances unobservable inputs would be used for the remainder of the asset's fair value estimate. 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 improvements on that land included in the fair value estimate for the facility.

Application of the cost approach (paragraphs B8 and B9)

F8 Paragraphs B8 and B9 state that the cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost), based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

F9 Accordingly, when measuring 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 (the subject asset) using the cost approach, an entity shall:

(a) estimate the cost currently required for a market participant buyer to acquire or construct a reference asset (ie the replacement cost of a reference asset) in accordance with paragraphs F11–F15; and

(b) adjust the estimate in (a) for any:

(i) differences between the current service capacity of the reference asset and the subject asset (for example, where the modern equivalent asset is engineered to a higher standard than the subject asset, such as where the subject asset is a building and the modern equivalent building has superior fire safety features and a greater number of lifts than the subject building); and

(ii) obsolescence (physical deterioration, functional obsolescence and economic obsolescence).

F10 A reference asset is a suitable alternative to the subject asset that the market participant buyer would consider in developing its pricing assumptions about the subject asset. Identifying the most appropriate reference asset involves the application of judgement and, on occasion, detailed valuation assessments in the circumstances of the subject asset. A reference asset could be a modern equivalent asset or a replica asset (where the utility offered by the subject asset could be provided only, or more cheaply, by a replica rather than a modern equivalent asset). A modern equivalent asset is an asset that provides similar function and equivalent utility to the subject asset, but is of a current design and constructed or made using current cost-effective materials and techniques.

Estimating the replacement cost of a reference asset

F11 For the purposes of paragraph F9(a), when estimating the replacement cost of a reference asset, an entity:

(a) assumes the reference asset will be acquired or constructed at the subject asset's existing location; and

(b) where paragraph F5 applies, shall use its own assumptions as a starting point in developing unobservable inputs to measure the costs currently required to acquire or construct a reference asset and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

F12 When applying paragraphs F9(a) and F11, the entity shall, subject to paragraph F14, include the following costs (among other costs) in the reference asset's replacement cost if they are judged to be necessarily incurred in the hypothetical acquisition or construction of the reference asset at the measurement date:

(a) costs required to restore another entity's asset, if the asset that would need restoration existed at the measurement date and would be disturbed in a hypothetical acquisition or construction of the reference asset. However, such costs are excluded if they relate to restoration of an asset of another entity included in the consolidated group (if any) to which the entity belongs;

(b) other disruption costs that would hypothetically be incurred when acquiring or constructing the reference asset at the measurement date (eg costs of redirecting traffic when replacement of the reference asset, such as a drainage pipe, disrupts the operation of a road); and

(c) if the subject asset is fixed to a parcel of land, site preparation costs for the reference parcel of land on which the reference asset would hypothetically be constructed, unless those site

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preparation costs are reflected (explicitly or implicitly) in the fair value measurement of the subject parcel of land.

F13 For the purposes of paragraph F12(c), site preparation costs include, but are not limited to:

(a) costs required to prepare the land (eg earthworks) for the hypothetical construction of the reference asset; and

(b) costs required to remove and dispose of any unwanted existing structures on the land to make way for the hypothetical construction of the reference asset.

F14 An entity applies judgement in determining which costs would necessarily be incurred in the hypothetical acquisition or construction of a reference asset with the same service capacity and condition as the subject asset at the measurement date. An entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraphs F12 and F13. However, an entity shall include all such costs for which data are reasonably available.

F15 When applying the cost approach in accordance with paragraph F9(a) to measure the fair value of a heritage asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, to the extent that its heritage features are an essential part of its service capacity, the replacement cost of the reference asset generally means the cost of replicating the heritage and other features of the subject asset (ie reproduction cost). Replication would assume reconstruction using modern cost-effective materials and processes, but sympathetic with the original heritage design and structure to the extent feasible.

Economic obsolescence

F16 For the purposes of paragraph B9 and paragraph F9(b)(ii), when a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows has suffered a reduction in demand for its services, the identification of 'economic (ie external) obsolescence' does not require a formal decision to have been made to reduce the physical capacity of that asset.

F17 When an asset described in paragraph F16 apparently has surplus capacity in view of current demand for its services, economic obsolescence is not identified for that asset if that 'surplus capacity' is necessary for stand-by or safety purposes (eg to deal with contingencies), even if it seldom or never is actively utilised. An example of an asset with stand-by capacity that is necessary for operational purposes, and would be replaced in full by a market participant buyer, is an electricity generation plant that maintains a generating capacity buffer that is typical of the industry to cater for periods of peak demand.

F18 An example of a strong indicator that economic obsolescence of assets would be identified when applying the principles in paragraphs F16 and F17 is a public school's buildings that have a capacity for 500 students but, due to demographic changes, a school for 100 students would meet current and reasonably foreseeable requirements, including a buffer needed for any temporary or underestimated student demand. In this example, based on these assumed facts alone (for simplicity), the school buildings' gross replacement cost would be based on the school's needed capacity (for 100 students), from which any other accumulated obsolescence related to the condition of the school buildings (eg physical obsolescence) would be deducted. Consistent with paragraph F16, the conclusion reached would not depend on whether a formal decision has been made to reduce the school buildings' capacity.

F19 Where an asset or a facility that is not held primarily for its ability to generate net cash inflows suffers a significant reduction in demand for its services, any economic obsolescence identified would not necessarily (and frequently would not) exhibit a linear relationship with that reduced level of demand. This is due to economies of scale causing some parts of an asset or a facility potentially needing replacement in full, or almost in full, despite a significant fall in demand for the services provided by the asset or facility, in which case the needed physical capacity of the asset or facility would not reduce linearly with the reduction in the level of demand for that asset's or facility's services. In the school example in paragraph F18, the administration office, canteen, toilet blocks, library and gymnasium might need replacing even for 100 students, although perhaps on a slightly smaller scale.

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Australian illustrative examples for not-for-profit public sector entities

These illustrative examples accompany, but are not part of, AASB 13. They illustrate aspects of Appendix F Australian implementation guidance for not-for-profit public sector entities *in AASB 13, but are not intended to provide interpretative guidance.*

The IASB published Illustrative Examples accompanying IFRS 13 Fair Value Measurement*, which are available on the AASB website. Those IASB examples illustrate aspects of IFRS 13 but are not intended to provide interpretative guidance. Those examples portray hypothetical situations illustrating the judgements that might apply when an entity measures assets and liabilities at fair value in different valuation situations. The following examples illustrate aspects of Appendix F* Australian implementation guidance for not-for-profit public sector entities *in AASB 13. They complement the IASB's Illustrative Examples.*

IE1 The following examples portray hypothetical situations. They are intended to illustrate how a not-for-profit public sector entity might apply some requirements of AASB 13 *Fair Value Measurement* to particular types of assets, on the basis of the limited facts presented. Although some aspects of the examples might be present in actual fact patterns, all relevant facts and circumstances of a particular asset would need to be evaluated when applying AASB 13. The evaluations in each example are not intended to represent the only manner in which AASB 13 could be applied.

Fair value of a non-financial asset not held primarily for its ability to generate net cash inflows and measured under the cost approach

Nature of costs included in the replacement cost of a reference asset (paragraphs F9(a) and F11–F15)

IE2 Examples 1–4 illustrate the costs included in the replacement cost of a reference asset for the purpose of measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows under the cost approach in accordance with paragraphs B8 and B9, and in paragraphs F9(a) and F11–F15.

Example 1 – Costs included in the gross replacement cost of a reference asset for a road

A local government (Council A) applies the revaluation model after recognition of each class of property, plant and equipment, as referred to in paragraph 31 of AASB 116 *Property, Plant and Equipment*.

Council A recognises roads and land under roads as separate classes of assets. It measures the fair value of its roads using the cost approach. This example illustrates the consideration of the costs to include in the gross replacement cost of a reference road. The measurement of accumulated obsolescence and the valuation of land are not addressed in this example.

As at 30 June 20X2, Council A controls a particular road (the subject road). In the process of using the cost approach to measure the fair value of the road, Council A determines which costs to include in the replacement cost of a reference road.

The costs in the list below, measured using prices as at that measurement date, relate to the reference road. For simplicity, in this example, it is assumed that the replacement of the reference road would occur within a year and, consequently, in the current market environment, material financing costs (from the perspective of the market participant) would not be incurred in replacing the reference road.

Costs (excluding costs to remove unwanted existing structures and disruption costs: see below)	Estimated cost as at 30 June 20X2
	$'000
Design work	2,200
Earthworks	10,000
Formation	5,000
Pavement	3,000
Surfacing	2,000
Total	22,200

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The following two types of costs also relate to the reference road as at 30 June 20X2.

Costs to remove unwanted existing structures and disruption costs

Council A's road is situated in a densely populated area, and Council A assesses that, since there is no vacant site in the surrounding area as at 30 June 20X2, to construct a road in a hypothetical acquisition, a market participant buyer would need to incur $2,000,000 to remove unwanted structures on the land to make way for the construction of the road. Council A did not reflect any land improvement or remediation costs in the fair value of the land under the road.

In addition, because the construction work to replace the subject road at the measurement date would require interruption of power and water supplies, Council A assumes that the majority of that construction work would occur at night-time to minimise disruption to the community. Council A estimates that, if that work were performed mainly at night-time, it would cost $1,000,000 as at 30 June 20X2. In contrast, if those construction works were performed during the daytime, Council A estimates that those costs would reduce to $500,000 as at 30 June 20X2. Council A determined that there is no reasonably available information indicating that another market participant would construct a road at the location of the Council's road during the daytime.

Estimating the gross replacement cost of a reference road as at 30 June 20X2

Costs to a market participant buyer

In accordance with paragraph F9(a), Council A applies judgement in determining which costs to include in a reference road as at the measurement date (30 June 20X2).

Council A concludes that each of the estimated costs listed above (which total $22,200,000) and the other necessarily incurred costs analysed below should be included in reference road's replacement cost because all components of the road, including the once-only earthworks and formation works, would need to be undertaken in a hypothetical construction of a reference road at the measurement date. This is because the cost to a market participant buyer to acquire or construct a substitute road of comparable utility at the subject road's existing location would include each of those costs, including any intrinsically linked disruption costs (eg traffic control and detour costs).

Costs of removal and disposal of unwanted existing structures

In addition, Council A includes the estimated costs of removal and disposal of unwanted existing structures at $2,000,000 as at 30 June 20X2 in the reference road's replacement cost. This is because 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 road's existing location, since there is no vacant land available in the area.

Disruption costs

Since there is no reasonably available information indicating that another market participant would construct a road at the location of the Council's road during the daytime, Council A uses the more costly night-time disruption costs of $1,000,000 in its estimated replacement cost of the reference road as at 30 June 20X2 rather than the lower daytime costs.

Consequently, Council A measures the gross replacement cost of the reference road as at 30 June 20X2 as $25,200,000 (ie $22,200,000 + $2,000,000 + $1,000,000).

Example 2 – Difference in the asset's operating environment affecting the reference asset's gross replacement cost

A local government (Council B) applies the revaluation model after recognition of each class of property, plant and equipment, as referred to in paragraph 31 of AASB 116.

Council B recognises buildings and land under buildings as separate classes of assets. It measures the fair value of its buildings using the cost approach. The measurement of accumulated obsolescence and the valuation of land are not addressed in this example.

As at 30 June 20X2, Council B uses the following assumptions in measuring one of its buildings at fair value:

- when the building was originally constructed by Council B (20 years ago), there were no internet cables underneath the site;
- ten years ago, another entity installed internet cables with protective pipes under the site where Council B's building is located;

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- Council B determined that, if its building was to be replaced as at the measurement date of 30 June 20X2, the other entity's pipes that protect the internet cables would be disrupted;
- the gross replacement cost necessary to restore those pipes disrupted during the hypothetical replacement of the components of Council B's building is $500,000; and
- Council B is not part of a group of entities that prepares consolidated financial statements.

Restoration costs for disrupted assets of another entity

Since Council B determined that if its building was to be replaced as at 30 June 20X2, the other entity's pipes would be disrupted, when measuring the fair value of Council B's building under the cost approach in accordance with paragraphs F9(a) and F12(a), the reference building's gross replacement cost would include the $500,000 restoration cost for the pipes.

The restoration cost is included despite the fact that Council B did not incur those costs when it originally constructed the building. This is because fair value measurements consider the conditions of the asset as at the measurement date and, in its circumstances, Council B determined that the cost to a market participant buyer to acquire or construct a substitute building at the existing location would necessarily include those restoration costs. In addition, because Council B is not part of a group of entities that prepares consolidated financial statements, the 'same group' scope exclusion for such costs in paragraph F12(a) does not apply to Council B.

Example 3 – Whether to adjust the entity's own assumptions in measuring a non-financial asset

The Transport Department of a State Government (Department B) estimates the fair value of its railway tracks as at 30 June 20X1 using the cost approach. Department B determined that there are no observable market prices for completed suitable railway tracks, and not all other market participant data required to measure the fair value of railway tracks are observable.

The cost currently required to acquire or construct Department B's modern equivalent railway tracks would be 30% lower if they were manufactured overseas instead of in Australia. There is no legal requirement for the tracks to be manufactured in Australia. However, the Commonwealth Government provides significant funding assistance for both the public sector and the private sector to acquire or replace public transport assets. The policy is that at least 50% of federally co-funded asset acquisitions must be manufactured in Australia. The State Government controlling Department B has identified railway tracks as one of the asset types the replacement of which contributes to meeting that domestic 50% requirement.

Based on the Commonwealth Government's unlegislated policy regarding Australian-manufactured content, Department B assesses that replacement of the railway tracks would, in the ordinary course of operations, be achieved by their manufacture in Australia. There is no reasonably available information indicating that another market participant would acquire railway tracks overseas.

Estimating the replacement cost of a reference asset as at 30 June 20X1

In accordance with paragraphs F5 and F11(b), Department B estimates the cost currently required for a market participant buyer to acquire or construct a reference asset by using its own assumptions as a starting point and adjusting those assumptions to the extent that reasonably available information indicates that other market participants would use different data.

Since there is no reasonably available information indicating that another market participant would acquire railway tracks overseas, Department B uses the more expensive costs of Australian manufacture in its estimated replacement cost of reference railway tracks as at 30 June 20X1, notwithstanding the absence of a legal requirement for their manufacture in Australia.

Site preparation costs (paragraph F12(c))

IE3 In respect of a non-financial asset not held primarily for its ability to generate net cash inflows and measured under the cost approach in paragraphs B8 and B9, Example 4 illustrates how a particular entity treats site preparation costs, in accordance with paragraph F12(c), when measuring the fair value of assets using the cost approach.

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Example 4 – Site preparation costs

Each Health Department of three jurisdictions was transferred land on 1 July 20X0 to be used to construct a remote airstrip for airborne health services.

The subject asset for each Health Department is the airstrip, and the valuation of land under the airstrip is not addressed in this example.

Each of those three Health Departments:

(a) recognises airstrips and land under airstrips as separate classes of asset;

(b) incurred $1,500,000 (excluding any site preparation costs) to construct the airstrip. The construction was completed in June 20X1;

(c) measures the fair value of the airstrip at current replacement cost under the cost approach; and

(d) determined that site levelling costs are not reflected (explicitly or implicitly) in the fair value measurement of the land under the airstrip because market participants acquiring the land for other purposes would not require a level site.

As at 30 June 20X1, the fair value of each Health Department's airstrip was estimated. For simplicity, the following common assumptions are made for each of those three Health Departments:

(a) it is assumed that the value of land in the proximity of the airstrip, and any site preparation costs, did not change between 1 July 20X0 and the measurement date of 30 June 20X1;

(b) the cost to construct the airstrip did not change since its construction;

(c) in relation to the requirements of paragraph F14, data are reasonably available for the site preparation costs and costs of constructing the airstrip; and

(d) any profit margin on the entity's own site preparation costs that would be demanded by external contractors and would increase the amount that not-for-profit public sector market participant buyers would be prepared to pay for the subject asset (as reflected in the asset's current replacement cost) is ignored.

The site preparation costs determined in accordance with paragraph F12(c) are analysed for the following assumed facts for the Health Department of each jurisdiction:

Jurisdiction A

The transferred land (airstrip site) was undulating, and the Health Department incurred a cost of $3,000,000 to level the site. Available land in the proximity of the airstrip site was also undulating.

Jurisdiction B

The airstrip site was undulating, and the Health Department incurred a cost of $3,000,000 to level the site. Available land in the proximity of the airstrip site was level. The Health Department would not have chosen a parcel of undulating land, but the land was transferred to it.

Jurisdiction C

The airstrip site was level. Available land in the proximity of the airstrip site was undulating.

<u>Site preparation cost assessments as at 30 June 20X1</u>

Jurisdiction A

It would be expected that another market participant buyer would need to incur a cost of $3,000,000 to level the reference parcel of land to be a fit-for-purpose site for the modern equivalent airstrip, since the only available land in the proximity is also undulating. Using the cost approach, the Health Department in Jurisdiction A measures the replacement cost of a reference airstrip as at 30 June 20X1 as $4,500,000 ($3,000,000 site levelling cost and $1,500,000 other construction cost).

Jurisdiction B

It would be expected that another market participant buyer could hypothetically purchase a level site, in which case, it would not need to incur the $3,000,000 site levelling cost. Using the cost approach, the Health Department in Jurisdiction B measures the replacement cost of a reference airstrip as at 30 June 20X1 as $1,500,000.

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Jurisdiction C

It would be expected that another market participant buyer, being unable to acquire a level site (to hypothetically construct a modern equivalent airstrip) as an alternative to acquiring the Health Department's airstrip, would be prepared to pay for the cost of site levelling when pricing the airstrip. The Health Department in Jurisdiction C measures the replacement cost of a reference airstrip as at 30 June 20X1 as $4,500,000 ($3,000,000 site levelling cost and $1,500,000 other construction cost), despite the fact that it did not actually incur any site levelling costs when the airstrip was constructed.

Including the $3,000,000 site levelling cost in the fair value measurement of the airstrip represents the advantage for a market participant buyer to possess the Health Department's airstrip (ie would be considered by a market participant buyer when pricing the airstrip). The advantage to a market participant buyer of possessing the Health Department's airstrip would include that the buyer would avoid the need to incur site levelling costs to prepare an undulating parcel of land for the construction of a reference airstrip.

This example assumes the value attributed by market participants to the site levelling is included in the estimated current replacement cost of the airstrip. That simplifying assumption would not necessarily be appropriate in all situations. For example, a particular entity with circumstances similar to those of the Health Department in Jurisdiction B might value the land under the airstrip using the market approach and the valuations before and after that site levelling might indicate that the site levelling increased the fair value of that parcel of land. Where the fair value of land incorporates the value attributed by market participants to site improvements, the cost of those improvements would, in accordance with paragraph F12(c), be excluded from the current replacement cost of improvements measured using the cost approach.

Economic obsolescence (paragraphs F16–F19)

IE4 Example 5 illustrates an assessment of whether economic obsolescence should be identified in relation to an asset not held primarily for its ability to generate net cash inflows, if the asset is measured at current replacement cost under the cost approach in paragraphs B8 and B9.

Example 5 – Kitchen with underutilised potential

A not-for-profit public sector institute (College A) measures the furniture and fittings in its college building at fair value using the cost approach. Its furniture and fittings include a kitchen of commercial standard necessary for training student chefs. The kitchen is an essential asset for College A to fulfil its teaching objectives, although it was planned not to be utilised outside the scheduled class times.

In this example, it is assumed that:

- the kitchen is scheduled to be used four hours per week;
- the amount of kitchen equipment aligns with the intended number of students per class;
- the current cost to replace the teaching kitchen with an identical capacity kitchen, less all forms of obsolescence other than any economic obsolescence, is estimated as at the measurement date (30 June 20X3) as $250,000; and
- if the kitchen requires replacing, College A would replace it with one that has the same physical capacity.

Current replacement cost assessment as at 30 June 20X3

College A assesses whether any economic obsolescence of its teaching kitchen has arisen as at the measurement date (30 June 20X3).

Although the teaching kitchen is operated with less intensity than physically possible, this does not indicate economic obsolescence has arisen. This is because the teaching kitchen is necessary for College A to fulfil its teaching objectives and is achieving the level of output planned. Another college 'stepping into the shoes' of College A would be willing to pay $250,000 to replace the kitchen's service capacity.

Therefore, no economic obsolescence is deducted from the amount of $250,000, which is the kitchen's current replacement cost as at 30 June 20X3.

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Compilation details
Accounting Standard AASB 13 *Fair Value Measurement* (as amended)

Compilation details are not part of AASB 13.

This compiled Standard applies to annual periods beginning on or after 1 January 2024. It takes into account amendments up to and including 15 December 2022 and was prepared on 18 December 2023 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 13 (August 2015) as amended by other Accounting Standards, which are listed in the table below.

Table of Standards

Standard	Date made	FRL identifier	Commence-ment date	Effective date *(annual periods … on or after …)*	Application, saving or transitional provisions
AASB 13	7 Aug 2015	F2015L01613	31 Dec 2017	*(beginning)* 1 Jan 2018	see (a) below
AASB 16	23 Feb 2016	F2016L00233	31 Dec 2018	*(beginning)* 1 Jan 2019	see (b) below
AASB 1060	6 Mar 2020	F2020L00288	30 Jun 2021	*(beginning)* 1 Jul 2021	see (c) below
AASB 2022-10	15 Dec 2022	F2023L00010	31 Dec 2023	*(beginning)* 1 Jan 2024	see (d) below

(a) Entities may elect to apply this Standard to periods beginning after 24 July 2014 but before 1 January 2018.

(b) Entities may elect to apply this Standard to annual periods beginning before 1 January 2019, provided that AASB 15 *Revenue from Contracts with Customers* is also applied to the same period.

(c) Entities may elect to apply this Standard to annual periods beginning before 1 July 2021.

(d) Entities may elect to apply this Standard to annual periods beginning before 1 January 2024.

Table of amendments

Paragraph affected	How affected	By … [paragraph/page]
6	amended	AASB 16 [page 44]
Aus28.1	added	AASB 2022-10 [5]
Aus29.1-Aus29.2	added	AASB 2022-10 [6]
Aus93.2	added	AASB 2022-10 [6]
Aus99.1	repealed	*Legislation Act 2003*, s. 48D
C6	added	AASB 16 [page 44]
AusC6.1	added	AASB 2022-10 [6]
Appendix E	replaced	AASB 1060 [page 60]
Appendix F	added	AASB 2022-10 [7]

Table of amendments to guidance

Paragraph affected	How affected	By … [paragraph/page]
Australian illustrative examples for not-for-profit public sector entities	added	AASB 2022-10 [8]

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Deleted IFRS 13 text

Deleted IFRS 13 text is not part of AASB 13.

7 The disclosures required by this IFRS are not required for the following:

(a) …;

(b) retirement benefit plan investments measured at fair value in accordance with IAS 26 *Accounting and Reporting by Retirement Benefit Plans*; and

(c) …

C4 *Annual Improvements Cycle 2011–2013* issued in December 2013 amended paragraph 52. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. An entity shall apply that amendment prospectively from the beginning of the annual period in which IFRS 13 was initially applied. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

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Basis for Conclusions on AASB 2015-7

This Basis for Conclusions accompanies, but is not part of, AASB 13. The Basis for Conclusions was originally published with AASB 2015-7 Amendments to Australian Accounting Standards – Fair Value Disclosures of Not-for-Profit Public Sector Entities.

Background

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in the Amending Standard. Individual Board members gave greater weight to some factors than to others.

BC2 AASB 13 *Fair Value Measurement* applies to annual reporting periods beginning on or after 1 January 2013. In 2014, the Board received feedback about AASB 13 from not-for-profit public sector entities following their implementation of the Standard, including feedback about some of the specified disclosures. These constituents were concerned that the costs of presenting the disclosures specified by the Standard, including potential disclosure overload for users of not-for-profit public sector general purpose financial statements, exceeded their benefits. The Board noted that it had considered similar issues in 2011 when making AASB 13, and had decided that no amendment to AASB 13 was necessary. However, following the feedback received, the Board decided, as a narrow scope project, to revisit whether some disclosure relief should be made available to not-for-profit public sector entities.

BC3 The Board undertook targeted outreach in late 2014 to further understand which disclosures were of concern to not-for-profit public sector entities, in particular, local governments, and the reasons for their concern. The Board's outreach activity included feedback from government entities, valuation experts and auditors. The Board received mixed feedback as to whether disclosure relief was necessary at this time.

BC4 In December 2014, the Board decided to limit its consideration of disclosure relief to:

(a) assets within the scope of AASB 116 *Property, Plant and Equipment* that are primarily held for their current service potential (for example, roads and water supply infrastructure) rather than to generate future net cash inflows; and

(b) disclosures in AASB 13 that apply solely to fair value measurements categorised within Level 3 in the fair value hierarchy. These disclosures help meet the objective noted in paragraph 91(b) of the Standard of providing users with information as to how fair value measurements using significant unobservable inputs affected profit or loss or other comprehensive income for the period, by requiring disclosure of information about the relative subjectivity of the fair value measurement.

BC5 The Board concluded that the feedback received did not suggest that a wider project scope was necessary to address matters raised about fair value disclosures (see also paragraphs BC7, BC18 and BC19). In April 2015, the Board evaluated these disclosures against its *Process for Modifying IFRSs for PBE/NFP ('Process')*. The *Process* allows for departures from the requirements of the equivalent International Financial Reporting Standard (IFRS) where not-for-profit specific reasons for the departure exist. The Board concluded that, for the interim, in relation to these assets, it is appropriate to depart from its policy of transaction neutrality for cost-benefit reasons in relation to certain disclosures specified by the Standard.

BC6 The Board issued Exposure Draft ED 262 *Fair Value Disclosures of Not-for-Profit Public Sector Entities* in May 2015. ED 262 exposed for public comment the Board's proposals to relieve not-for-profit public sector entities from certain disclosures specified by AASB 13, including the Board's rationale for its proposals. Following the consultation period, and after considering constituent comments received on the Exposure Draft, the Board decided to proceed with its proposals to make amendments to AASB 13 to relieve not-for-profit public sector entities from disclosing, for assets within the scope of AASB 116 that are primarily held for their current service potential rather than to generate future net cash inflows:

(a) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, quantitative information about the significant unobservable inputs used in the fair value measurement;

(b) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains and losses for the period included in profit or loss that is attributable to the change in unrealised gains or losses relating to the assets held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised; and

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(c) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. Where there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, the disclosure of a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement will also not be required.

BC7 The Board intends to revisit the relief pending the outcome of related current Board projects, including its projects on the review of the Reduced Disclosure Regime (Tier 2), Australian Reporting Framework, and Conceptual Framework, to assess the extent to which outcomes from those projects address the factors that led to the Board's decisions noted above. The Board acknowledged that constituents also had other concerns with applying AASB 13, including various measurement concerns. The Board noted that these issues were beyond the scope of the current narrow-scope project, but would be considered as part of a broader future Board project.

Significant issues

Property, plant and equipment held by not-for-profit public sector entities

BC8 The Board discussed the prevailing practice in the Australian not-for-profit public sector, compared to other sectors, of revaluing property, plant and equipment subsequent to initial measurement and recognition. It noted that assets such as road infrastructure and national parks were typically only held by public sector entities, but did not consider the nature of such assets in itself to be a sufficient sector specific differentiator, as assets held by private sector entities may similarly vary significantly across entities operating in different industries.

BC9 The Board noted that property, plant and equipment is primarily held for the purposes of delivering the not-for-profit entity's public service objectives rather than being held to generate net cash inflows. The Board considered whether the relief should be extended to similar assets held by not-for-profit entities in the private sector. The Board observed that private sector entities, including not-for-profit private sector entities, may similarly hold assets other than for the purpose of generating net cash inflows. However, given the diversity of assets held by not-for-profit public sector entities, the information about assets held for their current service potential was likely to be different from such assets held by private sector entities.

BC10 The Board considered the extent and variety of long-lived assets measured on the fair value basis in the public sector and noted the resultant impact on the number of classes of assets determined for the purposes of satisfying the disclosure requirements of AASB 13. The Board observed that, in many instances, the valuation technique applied to these assets used unobservable inputs (Level 3 inputs) and that the assets were predominantly categorised within Level 3 in the fair value hierarchy for the purposes of making the disclosures specified by AASB 13. The Board discussed examples of fair value disclosures made in published financial statements of not-for-profit public sector entities. The Board observed that the reported range of many inputs, for example, the cost per square metre applied in the valuation of heritage buildings and the adjustment made to reflect the market-participant restricted use of an asset, varied widely within an asset class. The Board noted that this variation is likely to be a function of the number of assets grouped into each class, and that it may be impractical for entities to provide disclosures at a more disaggregated level.

Balance of costs and benefits

BC11 The Board concluded that it is appropriate to depart from its policy of transaction neutrality for assets within the scope of AASB 116 that are primarily held for their current service potential rather than to generate future net cash inflows for cost-benefit reasons. This conclusion takes into account the extent and variety of long-lived assets held by public sector entities measured on the fair value basis and categorised within Level 3 in the fair value hierarchy.

BC12 As part of its considerations, the Board had regard to the benefits of the disclosures recognised by the International Accounting Standards Board (IASB) in its Basis for Conclusions to IFRS 13 *Fair Value Measurement*. Having regard to its observations in paragraphs BC8-BC10, the Board considered that the relative costs of requiring not-for-profit public sector entities to disclose quantitative information about the significant unobservable inputs in fair value measurements of property, plant and equipment that are categorised within Level 3 in the fair value hierarchy, and the narrative description of the sensitivity of

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certain fair value measurements to changes in unobservable inputs, would generally be greater than they are for private sector entities. At the same time, the benefits would not be as great having regard to the number of assets leading to a wide range of inputs within each class of assets for which disclosure is made and the information needs of users for such assets, particularly in the context of the very specialised nature and limited alternative use of the assets. The Board similarly considered the costs of making the disclosure specified by paragraph 93(f) of AASB 13 to exceed the benefits to users of the disclosure, given the relative usefulness of the additional information to users of not-for-profit public sector general purpose financial statements.

BC13 As part of its consideration of the costs versus the benefits of presenting the disclosures specified by paragraphs 93(d), 93(f) and 93(h)(i) of AASB 13, the Board observed that many not-for-profit public sector entities had only recently applied AASB 13. The Board discussed whether the concerns raised were reflective of underlying costs associated with implementing the Standard in a not-for-profit public sector environment, or whether the costs were largely transitional in nature. For example, the Board noted that the requirement to disclose a narrative description of the sensitivity of certain fair value measurements to unobservable inputs was likely to be transitional as it did not appear to be well understood in practice despite an example of the disclosure being included in the Illustrative Examples accompanying IFRS 13. The Board decided that the relative costs to not-for-profit public sector entities of presenting these disclosures were more than transitional in nature.

BC14 The Board also observed that IFRS 13 has not yet been incorporated into International Public Sector Accounting Standards (IPSASs) as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants. Accordingly, for not-for-profit public sector entities, the extent of the disclosures specified by Australian Accounting Standards of the fair value measurements of property, plant and equipment held primarily for their current service potential presently exceeds those specified under IPSASs. The Board noted that future decisions of the IPSASB on public sector measurement and the accounting for heritage and infrastructure assets may prompt a need to revisit its present decisions on the costs versus benefits of the relief provided (see also paragraph BC7).

BC15 The Board decided that it was not necessary to provide relief to entities from disclosing the reconciliation of movements in each class of assets measured at fair value and categorised within Level 3 in the fair value hierarchy required by paragraph 93(e) of AASB 13 or the valuation processes used by the entity required by paragraph 93(g). The Board decided that these disclosures provided useful information without imposing significant additional ongoing costs. In particular, the Board considered that the information required to prepare the necessary reconciliations was likely in many cases to be available in the underlying accounting records.

BC16 The Board noted that entities would continue to be required to disclose a description of the valuation technique(s) and the inputs used in the fair value measurement in accordance with paragraph 93(d) of AASB 13. The Board expects, in most instances, that this disclosure together with other disclosures specified in AASB 13 and other Australian Accounting Standards (for example, AASB 101 *Presentation of Financial Statements* and AASB 116), would provide users of not-for-profit public sector general purpose financial statements with sufficient information about fair value measurements for decision-making purposes. The Board observed that the relief introduced into AASB 13 by this Standard does not override the general disclosure objective of AASB 13 as described in paragraph 91 of that Standard.

BC17 The Board observed that paragraph Aus93.1 of AASB 13 does not prevent a not-for-profit public sector entity from presenting some, or all, of the disclosures specified in paragraphs 93(d), 93(f) and 93(h)(i) in its general purpose financial statements.

Other issues

Extension of relief to other assets held by not-for-profit public sector entities

BC18 The Board discussed whether the relief from disclosure should be extended to include investment properties within the scope of AASB 140 *Investment Property* or financial assets held by not-for-profit public sector entities that are measured at fair value and categorised within Level 3 of the fair value hierarchy. The Board decided not to extend the relief to such assets as it did not regard there to be differences in the purposes these assets are held, whether held by a for-profit private sector entity or not-for-profit public sector entity. Further, the Board considered that, for such assets, the costs of providing the disclosures did not outweigh the benefits from making those disclosures in general purpose financial statements. The Board noted that, unlike property, plant and equipment, there was not necessarily a significant difference between the sectors with regard to the extent to which fair value measurement is applied to these assets.

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BC19 The Board also discussed whether the relief from disclosure should be extended to include other assets (besides financial assets and investment properties) held by not-for-profit public sector entities that are measured at fair value and not held primarily for their current service potential. The Board noted that it had decided to keep the scope of its project narrow, and observed the role of materiality when considering whether specified disclosures should be included in general purpose financial statements.

Application date and transitional provisions

BC20 The Board considered the application date of the amendments to AASB 13. The Board decided that the amendments should apply to annual reporting periods beginning on or after 1 July 2016, and to permit early adoption of the amendments. The Board noted that early adoption would allow not-for-profit public sector entities to immediately access the disclosure relief.

BC21 The Board decided that no specific transitional provisions were necessary as the amendments relate to providing relief from disclosure. Accordingly, the requirements of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* apply to the amendments.

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Basis for Conclusions on AASB 2022-10

This Basis for Conclusions accompanies, but is not part of, AASB 13. The Basis for Conclusions was originally published with AASB 2022-10 Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard, which amends AASB 13 *Fair Value Measurement* for application by not-for-profit public sector entities. It sets out the reasons why the Board developed the Standard, the approach taken to developing the amendments and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for undertaking the 'Fair Value Measurement for Not-for-Profit Public Sector Entities' Project

Majority of non-financial assets in the public sector are measured at fair value

BC2 The Financial Reporting Council (FRC) issued a direction to the Board to require the Whole of Government (WoG) and the General Government Sector (GGS) to harmonise with Government Finance Statistics (GFS) requirements. Consequently, AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires each WoG and GGS to elect an accounting treatment that aligns with GFS principles and requirements where an Accounting Standard permits a choice (AASB 1049 paragraph 13). Because GFS requires assets and liabilities to be measured at current market value, this has resulted in each WoG and GGS electing to apply the revaluation model as its accounting policy and measure its non-financial assets, such as property, plant and equipment, at fair value under AASB 13.

BC3 Although AASB 1049 requires only WoG and GGS to align with GFS principles, some stakeholders from the public sector have informed the Board that the Treasury or Finance Department (or other authority) or the Office of Local Government in each jurisdiction has issued instructions to require the other public sector entities in their jurisdiction to also elect the accounting treatments that align with GFS principles, which has led to the majority of non-financial assets of public sector entities being measured at fair value.

Inconsistency in applying the requirements of AASB 13

BC4 The Board initially considered the application of AASB 13 for not-for-profit and public sector entities in 2011 when IFRS 13 *Fair Value Measurement* was issued. At its March 2011 and June 2011 meetings, the Board decided not to include any not-for-profit entity modifications to the requirements of IFRS 13 adopted in AASB 13. At that time, the Board considered that even though many non-financial assets in the public sector might have a specialised nature or that observable market inputs might not be readily available, a public sector entity would be able to measure the fair value of such assets at current replacement cost, under the cost approach in IFRS 13.

BC5 At its December 2014 meeting, the Board considered feedback from stakeholders regarding the application of AASB 13. The Board decided to undertake a narrow-scope project to give relief from certain AASB 13 disclosures, limited to items of property, plant and equipment within the scope of AASB 116 *Property, Plant and Equipment* that are held primarily for their current service capacity rather than primarily to generate future net cash inflows, in relation to disclosure of quantitative and qualitative information about the significant unobservable inputs used in the fair value measurement of such assets. This project resulted in AASB 2015-7 *Amendments to Australian Accounting Standards – Fair Value Disclosures of Not-for-Profit Public Sector Entities*.

BC6 During the due process of developing AASB 2015-7 and consideration of Invitation to Comment ITC 34 *AASB Agenda Consultation 2017–2019* (in which the Board sought views on its priorities for its work program for the period 2017–2019), some stakeholders in the public sector asked the Board to provide guidance clarifying how to apply the requirements in AASB 13 to the fair value measurement of public sector entity assets.

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BC7 Many stakeholders in the public sector commented that applying AASB 13 had been challenging and costly. They requested guidance on how to measure the fair value of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, in particular (but not limited to):

(a) the market participant assumptions to use in measuring fair value 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;

(b) how government-imposed public-sector-specific restrictions on non-financial assets should be taken into account;

(c) how to measure the fair value of public sector entity assets using the cost approach; and

(d) the concept of obsolescence under the cost approach.

BC8 The Board was advised that the measurement issues are pervasive in the not-for-profit public sector and involve inconsistent practical application of the principles of AASB 13.

BC9 In addition, in considering its Service Concession Arrangements: Grantors Project, the Board decided at its February 2016 meeting that, because a service concession asset is an asset that the grantor uses for its service potential to achieve public service objectives (rather than to generate net cash inflows), only the cost approach to measuring fair value is relevant and, where the operator has been granted the right to future cash flows, this need not be considered in the measurement of the grantor's service concession asset. In developing AASB 1059 *Service Concession Arrangements: Grantors*, the Board noted that it did not provide guidance on the measurement of service concession assets on the grounds that this would best be developed in a future project on the measurement of public sector assets – the Fair Value Measurement for Not-for-Profit Public Sector Entities Project (FVM project).

Due process

Fair Value Project Advisory Panel

BC10 The Board established the Fair Value Project Advisory Panel (the Panel) to provide a forum for the Board to consult with on specific fair value measurement issues. The Panel consists of industry experts with experience in dealing with fair value measurement issues, and includes asset valuers and preparers and auditors of financial statements. The Board held numerous meetings with the Panel over the course of the project. The FVM project has been assisted considerably by extensive input from Panel members.

BC11 As part of the FVM project, the Board also consulted with some asset valuers and the Australian Property Institute to seek understanding of how asset valuations are carried out in practice, and whether (and, if so, in what manner) the principles in AASB 13 differ from these practices.

Stakeholder feedback on the IPSASB's Measurement project

BC12 In April 2021, the International Public Sector Accounting Standards Board (IPSASB) issued Exposure Draft ED 77 *Measurement*. If approved as a final pronouncement, ED 77 would establish a single comprehensive Standard that identifies and defines the measurement bases used in IPSAS for not-for-profit public sector entities.

BC13 ED 77 was developed based on the view that the fair value measurement basis under IFRS 13 (which is adopted in AASB 13) would be applicable to assets held for their financial capacity, but would be inappropriate for measuring the current value of assets held for their operational capacity (ie assets not held primarily for their ability to generate net cash inflows). Instead, the IPSASB proposed a different current value measurement basis – current operational value – for measuring the current value of assets held for their operational capacity.

BC14 In contrast with fair value, which is a market-participant-based exit value reflecting an asset's highest and best use, current operational value is proposed to be an entity-specific entry value based on an asset's current use. The IPSASB proposed that the same three measurement techniques – the market, income and cost approaches – would be applicable in estimating both:

(a) an asset's fair value, for assets held primarily for their financial capacity; and

(b) an asset's current operational value, for assets held primarily for their operational capacity.

BC15 In accordance with paragraph 20 of *The AASB's Approach to International Public Sector Accounting Standards* (October 2019), in May 2021 the Board issued ITC 45 *Request for Comment on IPSASB*

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Exposure Drafts ED 76 Conceptual Framework Update: Chapter 7, *Measurement of Assets and Liabilities in Financial Statements and ED 77* Measurement, to obtain Australian stakeholders' views on the IPSASB's proposals.

BC16 The Board added AASB specific matters for comment in ITC 45 to specifically obtain views on whether Australian stakeholders would prefer that the Board adopts, in respect of current value measurement of non-financial assets of not-for-profit entities not held primarily for their ability to generate net cash inflows, the IPSASB's proposed current operational value measurement basis or continues requiring the fair value measurement basis.

BC17 The Board received six comment letters on ITC 45. Based on those comment letters and on the feedback received from related outreach activities, the Board noted that a significant majority of stakeholders that responded to ITC 45, including not-for-profit public sector entities' financial statement preparers, auditors and valuers, indicated that fair value under AASB 13 is appropriate for measuring the current value of all non-financial assets held by not-for-profit public sector entities, whether held primarily for their financial capacity or operational capacity, and should remain the sole current value measurement basis.

BC18 The majority of these stakeholders also commented that they agree with applying the 'highest and best use' and 'market participants' concepts under fair value for measuring the current value of non-financial assets not held primarily for their ability to generate net cash inflows, although some stakeholders have sought the Board's guidance to assist entities to understand better how these concepts should be applied in the not-for-profit public sector context. They 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, as proposed in the IPSASB's Exposure Drafts. This is because it would avoid:

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

(b) 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

(c) reporting to users of financial statements of not-for-profit public sector entities current values based on mixed measurement bases, which would reduce the comparability and understandability of the totals reported.

BC19 At the date of issue of this Standard, the IPSASB was continuing to develop a Measurement Standard and related amendments to its Conceptual Framework based on its proposals in ED 76 and ED 77.

Stakeholder feedback on AASB ED 320

BC20 The Board considered the comments received on ITC 45 and continued developing guidance to assist not-for-profit public sector entities to apply the principles of AASB 13 more consistently in measuring their non-financial assets not held primarily for their ability to generate net cash inflows, in addressing the stakeholders' requests noted in paragraph BC7.

BC21 The Board issued Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* in March 2022 to propose adding authoritative implementation guidance on how to apply the following principles in measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows:

(a) the market participant assumptions to use;

(b) the circumstances in which the asset's current use is presumed to be its highest and best use;

(c) the 'financially feasible use' aspect of highest and best use (AASB 13 paragraph 28(c)); and

(d) how to measure the current replacement cost of such a non-financial asset, including the nature of component costs to include in that amount, the factors to consider in identifying economic obsolescence, and whether current replacement cost should be measured assuming the asset's replacement occurs in its existing location.

BC22 Another key purpose of developing additional guidance is to enable application of AASB 13 in a more cost-effective manner by clarifying its application, including clarifying the extent to which preparers of financial statements need to search for information in the absence of observable market inputs.

BC23 ED 320 was exposed for 90 days, and the Board conducted three virtual roundtables to elicit feedback on the proposals. The Board received sixteen written submissions and observed that:

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(a) other than one respondent who disagreed with most aspects of the ED 320 proposals, generally, stakeholders supported modifying AASB 13 (to varying degrees) to assist not-for-profit public sector entities in applying the principles noted in paragraph BC21; but

(b) significant refinements would be needed in the drafting of the modifications to address potential application issues.

BC24 The Board considered the feedback on ED 320 and revised the drafting of the modifications. The Board developed a Fatal-Flaw Review draft version of the Standard to identify any unintended consequences of the revisions made to the proposed modifications.

Stakeholder feedback on the Fatal-Flaw Review draft version

BC25 In October 2022, the Board issued for comment a Fatal-Flaw Review draft version of the Standard. The Board received written submissions on the draft Standard from three respondents, who also responded to ED 320. The Board also received comments from Panel members during a Panel meeting held in November 2022.

BC26 Of the three respondents who provided a written submission:

(a) one supported all the Board's proposals;

(b) one supported all the proposed principles in the draft Standard but commented that certain areas of the draft Standard can be refined; and

(c) the ED respondent who disagreed with most aspects of the ED 320 proposals elaborated on their disagreement with the Board's proposals.

BC27 The respondent referred to in paragraph BC26(c) expressed the following concerns about the proposals in their submissions on ED 320 and the Fatal-Flaw Review draft:

(a) fair value measurements of some assets would be affected by an entity's subjective assessment of whether the asset is held primarily for its ability to generate net cash inflows (which therefore would determine whether the asset's fair value measurement is subject to the proposed modifications to AASB 13). Uniform guidance on fair value measurement should be applicable to all reporting entities, regardless of their sector, because the principles of valuation hold regardless of the sector in which the entity controlling the asset operates;

(b) modifying AASB 13, such as adding to AASB 13 criteria that constrain when an alternative use may be identified as an asset's highest and best use and introducing non-financial influences into the concept of financial feasibility, would be likely to result in departures from the principles of IFRS 13; and

(c) the notion that hypothetical not-for-profit public sector market participant buyers exist for public sector entity assets is ethereal and unrealistic. The respondent considers that the hypothetical transaction underpinning the fair value concept in AASB 13 should be supported by actual market activity, or the generation of actual cash flows that support assumptions about what that market activity might be.

BC28 In addition, the respondent made the following comments:

(a) fair value and market value are one and the same. The same estimate of fair value should result for a given asset, regardless of whether the market approach, income approach or cost approach is used; and

(b) the costs associated with the provision of community service obligations are never more transparent than when a new public sector asset is valued at less than its cost of acquisition, and when the continuing use of a community asset is deemed not to be that asset's highest and best use. The public sector does not necessarily make investment decisions based on the concept of highest and best use. However, users of financial statements should be provided the opportunity to identify when this occurs.

BC29 In respect of the respondent's concerns noted in paragraph BC27(a), the Board observed that a precedent exists in the requirements of Australian Accounting Standards for not-for-profit entities to base the measurement of assets on whether they are held primarily to generate net cash inflows. AASB 136 *Impairment of Assets* does not apply to specialised assets of not-for-profit entities that are held for continuing use of their service capacity and not held primarily for their ability to generate net cash inflows if those assets are regularly revalued to fair value (AASB 136 paragraph Aus5.1). In relation to the respondent's comment – that uniform guidance on fair value measurement should be applicable to all reporting entities regardless of their sector – the *AASB Not-for-Profit Entity Standard-Setting Framework* sets out the circumstances in which not-for-profit or public-sector-specific modifications to IFRS Standards

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are justified. As discussed in paragraphs BC39–BC41, the Board considers that all decisions leading to the modifications to AASB 13 set out in this Standard complied with that Framework.

BC30 In respect of the respondent's comment about departures from the principles of IFRS 13, noted in paragraph BC27(b), the Board took into account the possibility of non-conformity with IFRS 13 in some fair value measurements, as explained in paragraphs BC37 and BC38. As noted in paragraphs BC39–BC41, the Board concluded that the particular features of the public sector – together with cost/benefit considerations – warrant that risk.

BC31 The Board observed that the notion of hypothetical not-for-profit public sector market participant buyers referred to in paragraph BC27(c) above is key to not measuring the fair values of many public sector entity assets at scrap value. This is supported by the IASB's Basis for Conclusions on IFRS 13, paragraph BC78, that "… In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset."

BC32 The IASB noted in paragraph BC79 of its Basis for Conclusions on IFRS 13 that sometimes an observed market price – one for sale on a stand-alone basis – will not reflect an asset's fair value (because it does not reflect the value that the asset contributes to the entity, which is achieved by using the subject asset in combination with other assets). The IASB's rationale seems to provide a precedent for concluding that hypothetical not-for-profit public sector market participant buyers would be willing to pay more than a stand-alone selling price for an asset if the asset generates greater benefits when used in combination with other assets.

BC33 The Board considered that the comments in paragraphs BC78 and BC79 of the IASB's Basis for Conclusions on IFRS 13 suggest that the respondent's view noted in paragraph BC28(a) – that the same estimate of fair value should result for a given asset, regardless of whether the market approach, income approach or cost approach is used – would not always hold true.

BC34 As noted in paragraph BC28(b), the respondent expressed a view that users of financial statements should always be provided the opportunity to identify when an asset is not generating the return expected from the asset's highest and best use. The Board considered that this concern stems mainly from the different perceptions of what an asset's highest and best use is and the respondent's disagreement with the Board's view that other not-for-profit public sector entities should be considered market participants for a non-financial asset of a not-for-profit public sector entity held primarily for its service potential rather than to generate net cash inflows (the subject asset). Under that Board view, another not-for-profit public sector market participant is likely to:

(a) be willing to pay a higher price, if necessary, for the subject asset than the amount on which an investment return is expected from any net cash inflows the subject asset generates; and

(b) continue the subject asset's current use (unless the presumption is rebutted) on the basis that the market participant 'stepping into the shoes' of the not-for-profit public sector entity holding the subject asset would use the asset to continue providing services to the community rather than for an alternative use.

BC35 As explained in paragraphs BC31and BC32 above, the Board's view is consistent with the view of the IASB in IFRS 13. Other respondents to ED 320/Fatal-Flaw Review draft expressed agreement with this view and support the Board's proposals. Accordingly, the Board decided to proceed with the modifications to AASB 13.

Comparison with IFRS 13

BC36 The Board observed that not-for-profit public sector entities complying with this Standard might not comply with IFRS 13.

BC37 This Standard makes the following modifications to the requirements of IFRS 13 adopted in AASB 13, which apply only to fair value measurements of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows:

(a) an entity is required to consider whether an asset's highest and best use differs from its current use only when, at the measurement date, it is:

(i) classified as held for sale or held for distribution to owners in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*; or

(ii) highly probable that the asset will be used for an alternative purpose to its current use (see paragraphs Aus29.1 and Aus29.2);

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(b) an asset's use is 'financially feasible' if market participants would be willing to invest in the asset's service capacity, considering both the capability of the asset to be used to provide needed goods or services to beneficiaries and the resulting cost of those goods or services (see paragraph Aus28.1);

(c) if both the market selling price of a comparable asset and some market participant data required to measure the fair value of an asset are not observable, the entity is required to use its own assumptions as a starting point in developing unobservable inputs to measure the fair value of the subject asset and adjust those assumptions to the extent that reasonably available information indicates that other market participants would use different data (see paragraphs F5 and F11(b)); and

(d) if an asset is measured using the cost approach, the entity is required:

  (i) to assume that the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location at the measurement date (see paragraph F11(a)); and

  (ii) not to identify economic obsolescence for the asset if the asset contains 'surplus capacity' necessary for stand-by or safety purposes (see paragraph F17).

BC38 IFRS 13 does not specify:

(a) that the entity's own data is required to be used as a starting point under certain circumstances. IFRS 13 paragraph 89 states that the entity's own data *may* be used as a starting point when developing unobservable inputs;

(b) any specific criteria for determining when market or other factors suggest that an alternative use of an asset by market participants would be the asset's highest and best use. Consequently, the modification of AASB 13 in paragraphs Aus29.1 and Aus29.2 – specifying that an entity is required to consider whether the asset's highest and best use differs from its current use only when, at the measurement date, it is classified as held for sale or held for distribution to owners in accordance with AASB 5 or it is highly probable that the asset will be used for an alternative purpose to its current use – creates the potential for particular fair value measurements to be non-compliant with IFRS 13. This is because applying paragraphs Aus29.1 and Aus29.2 might delay the identification of a higher and better alternative use compared with application of paragraph 29 of IFRS 13 alone. The Board concluded such potential for non-compliance with IFRS 13 is warranted by the unique aspects of the processes in the public sector for selling, distributing to owners or redeploying assets (see paragraphs BC52–BC59);

(c) that the capability of the asset to be used to provide needed goods or services and the resulting cost of those goods or services need to be considered (instead of whether a use of the asset would generate an investment return on that asset) when considering whether a use of an asset is financially feasible (see paragraphs BC82–BC88); and

(d) how the cost approach should be applied, beyond the brief requirements in IFRS 13 paragraphs B8 and B9.

The requirements of this Standard noted in paragraphs BC37 and BC38 might not comply with IFRS 13.

BC39 The Board made reference to paragraphs 25 and 30 of the *AASB Not-for-Profit Entity Standard-Setting Framework*, which state that, when justified, the Board would modify IFRS Standards to address not-for-profit specific issues, including those involving:

(a) undue widespread and significant diversity in accounting practices (see paragraph 25(g)); and

(b) cost or effort of preparing and disclosing information that outweighs the benefits to users (see paragraph 30(h)).

BC40 As mentioned in paragraphs BC7 and BC8, many public sector stakeholders commented that applying AASB 13 had been challenging and costly and that the measurement issues are pervasive in the not-for-profit public sector and involve inconsistent practical application of the principles of AASB 13. Accordingly, the Board undertook the FVM project to provide guidance that:

(a) assists the not-for-profit public sector to apply the principles of AASB 13 more consistently; and

(b) enables the application of AASB 13 in a more cost-effective manner by clarifying its application, including clarifying the extent to which preparers of financial statements need to search for information in the absence of observable market inputs to fair value measurements.

BC41 In addition, the modifications in paragraphs Aus29.1 and Aus29.2 regarding an asset's highest and best use are designed to reduce the cost and effort of a not-for-profit public sector entity resulting from searching

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unnecessarily for possible alternative uses of an asset not held primarily for its ability to generate net cash inflows.

BC42 The Board observed that the modifications to AASB 13 in this Amending Standard:

(a) would not necessarily change practice for some not-for-profit public sector entities; and

(b) do not indicate that entities changing practice in how they measure relevant assets made an error in applying the existing requirements of AASB 13.

The highest and best use of a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs Aus28.1, Aus29.1 and Aus29.2)

BC43 The Board noted that paragraph 29 of AASB 13 states a rebuttable presumption that an asset's current use is its highest and best use. Paragraph 29 of AASB 13 states that "… an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset."

BC44 Regarding whether the current use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is presumed to be its highest and best use, the Board observed that IFRS 13 paragraph 29 (quoted in paragraph BC43) and the related IASB Basis for Conclusions paragraph (quoted below) provide guidance:

> IFRS 13 does not require an entity to perform an exhaustive search for other potential uses of a non-financial asset if there is no evidence to suggest that the current use of an asset is not its highest and best use … the IASB concluded that in many cases it would be unlikely for an asset's current use not to be its highest and best use after taking into account the costs to convert the asset to the alternative use. (IFRS 13 paragraph BC71)

BC45 However, despite that IASB text, some stakeholders requested the Board to provide additional guidance about the highest and best use of non-financial assets referred to in paragraph BC44. These stakeholders do not consider the cost incurred to search for possible alternative uses of such an asset is justified when such an asset is very unlikely to be used for a purpose other than its current use, for the many cases in which the asset is:

(a) specialised, especially if the costs to convert the asset to the alternative use are high; and

(b) being used to provide necessary services to the public and, therefore, the public sector entity holding the asset is highly likely to continue using the asset to provide those services.

BC46 The Board considered the request and decided to modify AASB 13 to reduce the cost and effort of an entity searching unnecessarily for possible alternative uses of a not-for-profit public sector entity's non-financial asset not held primarily for its ability to generate net cash inflows. This is discussed in paragraphs BC49 to BC81.

BC47 In addition, stakeholders requested the Board to provide guidance assisting not-for-profit public sector entities to apply the three concepts specified in paragraph 28 of AASB 13 for identifying the highest and best use of non-financial assets not held primarily for their ability to generate net cash inflows (which has practical effect when the presumption that the asset's current use is its highest and best use is rebutted, after considering the circumstances in paragraphs Aus29.1 and Aus29.2 in which that might be the case). The Board decided that, in respect of such assets, implementation guidance is needed for the 'financially feasible use' concept in paragraph 28(c) of AASB 13, but implementation guidance is not needed regarding the application of the 'physically possible use' and 'legally permissible use' concepts in paragraphs 28(a) and 28(b). The Board's views on the 'physically possible use' and 'legally permissible use' concepts are set out in paragraphs BC96–BC112.

BC48 The Board concluded that, although the 'financially feasible use' concept should apply to fair value measurements of any non-financial asset, for an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, paragraph 28(c) of AASB 13 should be clarified in terms relevant to the not-for-profit public sector environment. Therefore, the Board added paragraph Aus28.1 in AASB 13. This is explained in paragraphs BC82–BC88.

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The presumption that an asset's current use is its highest and best use (paragraphs Aus29.1 and Aus29.2)

Proposal in ED 320

BC49 The Board proposed in ED 320 that, for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, the asset's current use – to provide particular public services – should be presumed to maximise the value of the asset unless evidence exists that, at the measurement date, the appropriate level of management of the entity has committed to a plan to sell (including distribute) the asset or to use the asset for an alternative purpose. The Board considered that a higher and better use than the asset's current use may be identified when the not-for-profit public sector entity has committed to a plan to sell such an asset or to use the asset for an alternative use, because the entity would have determined that the alternative use would generate greater benefits than its current use.

BC50 For an asset subject to a committed-to plan of sale by an appropriate level of management, a conclusion that the asset's highest and best use differs from its current use could be reached earlier than when the asset meets the classification requirement as 'held for sale' under AASB 5. Under paragraphs 6–8 of AASB 5, among other conditions, a non-current asset is classified as held for sale only if the asset is available for immediate sale and its sale must be highly probable. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. In addition, subject to limited exceptions, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, and it must be unlikely that significant changes to (or withdrawal of) the plan will occur.

BC51 Under the Board's proposal in ED 320, for an asset subject to a committed-to plan of sale by an appropriate level of management, to conclude that the asset's highest and best use differs from its current use, the entity's appropriate level of management need not have initiated, at the measurement date, an active programme to:

(a) locate a buyer; or

(b) complete the plan to use the asset for an alternative purpose.

Stakeholder feedback on ED 320 and the Board's redeliberations

BC52 Eleven of the twelve ED respondents to this topic expressed support for modifying AASB 13 to limit the circumstances in which the current use presumption would be rebutted. The respondent who disagreed with any modification to AASB 13 that would constrain identifying a higher and better alternative use of an asset considered that the hypothetical transaction underpinning the fair value concept in AASB 13 should be supported by actual market activity or the generation of actual cash flows that support assumptions about what that market activity might be. They consider that if an asset's fair value measurement does not reflect its market value, it would inadvertently affect an entity's assessment of the true cost of the assets being deployed for service delivery.

BC53 That respondent was concerned that the ED proposals would affect fair value measurements of some public sector assets due to:

(a) the subjective assessment by an entity's management of whether an asset is held primarily for its ability to generate net cash inflows;

(b) the decision by the entity's management about how the asset will be used; and

(c) the notion of a hypothetical not-for-profit public sector entity market participant buyer being ethereal and lacking market activity on which to base a fair value estimate.

BC54 In response to that respondent's concerns, as noted in paragraphs BC31 and BC32, the Board observed that the notion of hypothetical not-for-profit public sector market participant buyers is key to not measuring the fair values of many specialised public sector entity assets at scrap value. This is supported by the IASB's Basis for Conclusions on IFRS 13, paragraph BC78, which states that "… In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset." Also, the IASB noted in paragraph BC79 of its Basis for Conclusions that sometimes an observed market price – one for sale on a stand-alone basis – will not reflect an asset's fair value (because it does not reflect the value that the specialised asset contributes to the entity, which is achieved by using the specialised asset in combination with other assets).

BC55 The Board considered that the IASB's rationale provides an equivalent precedent for hypothetical not-for-profit public sector market participant buyers existing for public sector entity assets at a higher level of aggregation than the unit of account for observed sales of individual public sector assets. In addition, the Board concluded that fair value estimates for non-financial assets not held primarily for their ability to

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generate net cash inflows should not depend on the net cash inflows expected to be generated by those assets.

BC56 The Board acknowledged the concern (noted in paragraph BC38(b)) that limiting the circumstances in which the current use presumption may be rebutted could result in some fair value measurements being non-compliant with IFRS 13 because they might delay the identification of a higher and better alternative use compared with application of paragraph 29 of IFRS 13 alone.

BC57 However, the Board considered that this potential for IFRS non-compliance should be insignificant. This is because the Board considers that a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows:

(a) often is different in nature from an asset with similar features but held primarily for its ability to generate net cash inflows, because the nature of the benefits it provides is different;

(b) is subject to a different operational (public sector) environment that reduces the likelihood – compared with that of an asset held by a private sector entity – of realising a potential opportunity to be sold for a higher and better alternative use, and therefore reduces the relevance of such an opportunity to assumptions made by market participants when pricing the asset;

(c) if specialised, is unlikely to be used for another purpose, especially if the costs to convert the asset to an alternative use are high; and

(d) often is being used to provide necessary services to the public and, therefore, another not-for-profit public sector entity stepping into the shoes of the public sector entity holding the asset would base its pricing decisions on the asset's current use.

BC58 Even if particular fair value measurements under the proposed modifications to AASB 13 were considered not to be compliant with IFRS 13, the Board concluded they would be justified on cost-benefit grounds in accordance with paragraph 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*. The proposal regarding the identification of an asset's highest and best use is designed to reduce the cost and effort of a not-for-profit public sector entity searching unnecessarily for possible alternative uses of an asset.

BC59 Some Board members consider that if AASB 13 is modified to specify when the asset's current use ceases to be its highest and best use, doing so should drive more consistency between the asset's use and the asset's value reported on financial statements, rather than reporting the asset's value based on a possible alternative use. In addition, the proposal would not restrict the choice of valuation techniques to apply in measuring a not-for-profit public sector entity's asset.

Timing of when the current use presumption may be rebutted

BC60 Although the significant majority of ED respondents agreed with modifying AASB 13 to limit the circumstances in which the current use presumption may be rebutted, some ED respondents disagreed that an entity's appropriate level of management having committed to a plan to sell the asset would, of itself, be sufficient to require an entity to reassess the asset's highest and best use (with a potential consequence that the asset's fair value would be remeasured). Those respondents argued that reassessing the asset's highest and best use should not occur until the asset has met the criteria for classification as 'held for sale' under AASB 5 and/or formal approval has been made to sell the asset or distribute it to owners.

BC61 They noted that, under the proposal in ED 320, when the asset subsequently meets the criteria for classification as 'held for sale' under AASB 5, another fair value estimate would need to be determined for the asset, and expressed concern that this outcome would cause undue cost and effort. They argued that, unlike for most assets held by for-profit entities, the sale of various assets held by not-for-profit public sector entities requires a complex and lengthy approval process (sometimes requiring legislative amendment) that can cause the elapse of a significant period between when an asset satisfies the 'committed-to plan to sell the asset' condition proposed in ED 320 and when the criteria for classification as 'held for sale' in AASB 5 are satisfied. For these reasons, they argued that applying the ED proposals would:

(a) give rise to a significant risk of premature (and additional) remeasurement because of the greater risk of changes in management plans stemming from the complexity of public sector processes for selling or redeploying assets;

(b) give rise to a significant risk of information leakage regarding sales of assets during a confidential tender process;

(c) obligate controlled entities to seek information about decisions by senior levels of government to which they might not be privy until sale of an asset becomes highly probable and/or imminent (ie when the criteria for classification as 'held for sale' are met). This is because, in the public sector environment, sometimes the plan to dispose of or redeploy an asset is initiated by a controlling

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entity of the holder of the asset, and the asset's holder does not learn of this plan until later (because the sale process for the asset is conducted confidentially for some time). Similarly, until an asset is ready for sale in the condition intended by an entity's appropriate level of management, a higher and better use for the asset is unlikely to be evident;

(d) be potentially difficult and subjective to apply, because it would often be difficult in a public sector environment to determine exactly when an entity's appropriate level of management has become 'committed to a plan' to sell an asset, and consequently be likely to result in significant inconsistency in practice; and

(e) not be consistent with a GAAP/GFS harmonisation objective, because being 'committed to a plan to sell an asset' is not an explicit concept that can be applied from a macroeconomic statistics perspective.

BC62 For the reasons described in paragraph BC61, those respondents argued that this issue is a public-sector-specific issue that warrants deeming that a higher and better use than current use would not arise until an asset satisfies the criteria for classification as 'held for sale' under AASB 5.

BC63 In developing ED 320, the Board was concerned that waiting until all the criteria in AASB 5 for classifying an asset as 'held for sale' are met could deprive users of financial statements of a not-for-profit public sector entity of useful information about an alternative use having become an asset's highest and best use, as supported by the due diligence underpinning a decision by the entity's appropriate level of management to commit to a plan to take one of those steps. For example, if an appropriate level of management commits to begin using an asset (such as equipment) for a commercial purpose (eg by leasing out that equipment) while awaiting approval of the asset's sale, it could deprive users of information about the asset's value if an entity waits until the classification criteria for being 'held for sale' in AASB 5 are met before taking into account the commitment to change the asset's use.

BC64 On balance, the Board considered that the concerns noted in paragraph BC61 outweigh these concerns in paragraph BC63. In addition, the Board noted that:

(a) in the public sector, many non-financial assets other than land are specialised assets without alternative uses; and

(b) the requirements of AASB 5 are well understood by preparers and auditors of financial statements of not-for-profit public sector entities. Therefore, aligning the timing of potentially identifying a higher and better alternative use with the criteria in AASB 5 should reduce the time and effort by preparers and auditors and reduce inconsistency in application.

BC65 Therefore, the Board decided to issue for comment a Fatal-Flaw Review draft version of the Standard to propose that an entity is not required to consider whether an asset's highest and best use differs from its current use unless the asset has met the criteria for classification as 'held for sale' under AASB 5 or it is highly probable that the asset will be used for an alternative purpose to its current use.

BC66 In reaching its decision referred to in paragraph BC65, the Board considered the other alternative to the ED proposals expressed by respondents, namely, identifying a higher and better use of an asset upon formal approval of selling the asset or distributing it to owners. The Board concluded that this other alternative would not sufficiently address the concerns expressed by respondents regarding the proposal in ED 320, because formal approval of sale or distribution to owners can precede sale by an extended period. In contrast, the AASB 5 criteria for an asset being 'held for sale' include that the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

BC67 Consistent with ED 320, and in contrast with AASB 5, the Board considered that it is not essential that a potential higher and better alternative use of an asset is identified only through a future sale of the asset: the asset's higher and better alternative use could be identified through future redeployment for an alternative purpose. Substantially the same point for requiring an entity to consider whether a higher and better alternative use of an asset might have arisen should apply to assets that would be sold or redeployed.

Proposal in Fatal-Flaw Review draft Standard

BC68 The Board noted that paragraphs 7 and 8 of AASB 5 require all the following criteria to be met for an asset to be classified as 'held for sale':

(a) the asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets;

(b) the appropriate level of management is committed to a plan to sell the asset;

(c) an active programme to locate a buyer and complete the plan has been initiated;

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(d) the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value;

(e) the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except for specific conditions permitted by paragraph 9 of AASB 5), and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(f) the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

BC69 The Board decided to propose in the Fatal-Flaw Review draft the overarching principle for potentially identifying a higher and better alternative use is that the sale or alternative use must be 'highly probable'. In the case of an asset with a potentially higher and better alternative use identified from a future sale or distribution to owners, the 'highly probable' test would be met when the asset meets the criteria for classification as 'held for sale' under AASB 5. For an asset with a higher and better alternative use identified from a future redeployment, the Board adapted the criteria in paragraphs 7 and 8 of AASB 5.

BC70 The following table outlines the AASB 5 criteria and the conditions proposed in the Fatal-Flaw Review draft for determining whether it is highly probable that the asset will be used for an alternative purpose.

<table>
<tr><th>Criteria in paragraphs 7 and 8 of AASB 5</th><th>The Board's decision when developing the Fatal-Flaw Review draft</th></tr>
<tr><td>Not applicable.</td><td>(i) Added a criterion that the alternative use of the asset is physically possible, legally permissible and financially feasible in accordance with paragraph 28 and the proposed paragraph Aus28.1.</td></tr>
<tr><td>(a) The asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets.</td><td>(ii) Adapted this criterion as "the asset is immediately available to be used for the alternative purpose in its present condition."</td></tr>
<tr><td>(b) The appropriate level of management is committed to a plan to sell the asset.</td><td rowspan="2">(iii) Adapted these two criteria as "the appropriate level of management is committed to a plan to change the usage of the asset to that alternative purpose, and an active programme to complete the plan has been initiated."</td></tr>
<tr><td>(c) An active programme to locate a buyer and complete the plan has been initiated.</td></tr>
<tr><td>(d) The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value.</td><td>Omitted criterion (d) because it is specific to a sale transaction and is not relevant for determining whether it is highly probable that an asset will be redeployed.</td></tr>
<tr><td>(e) The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except for specific conditions permitted by paragraph 9 of AASB 5), and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.</td><td>(iv) Adapted this criterion as "The change in the asset's use is expected to be completed within one year from the measurement date. Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."</td></tr>
<tr><td>(f) The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.</td><td>(v) Adapted this criterion as "Any approvals required to change the asset's usage have been obtained."</td></tr>
</table>

Stakeholder feedback on the Fatal-Flaw Review draft and the Board's redeliberations

Assets that will be used for an alternative purpose

BC71 During the outreach connected to the Fatal-Flaw Review draft, some stakeholders requested the Board to clarify the conditions determining whether an asset would be judged to be highly probable to be used for an

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alternative purpose. After considering those stakeholder comments, the Board decided to revise those proposed conditions (noted in the table in paragraph BC70), as follows:

(a) amend the criterion in (iv) of the table to:

  (i) clarify the proposed principle that "the change in the asset's use is expected to be completed within one year from the measurement date" by stipulating the more specific condition that "based on reasonably available information, it is highly probable that the current use of the asset will cease under the plan within one year" (of the measurement date); and

  (ii) delete the condition that: "Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn" because that condition is encompassed by the condition that cessation of the asset's current use within one year is highly probable; and

(b) remove the proposed condition in (ii) of the table – that "the asset is immediately available to be used for the alternative purpose in its present condition". In respect of an asset that will be redeployed, this condition may sometimes be satisfied after satisfying condition (iv).

BC72 In making the decisions noted in paragraph BC71(a), the Board:

(a) considered that, if reasonably available information exists that cessation of the asset's current use will occur within one year of the measurement date, and the other conditions in paragraph Aus29.2 are met, there is sufficient evidence to indicate that the asset's current use is no longer its highest and best use. It would be inappropriate for an asset to continue to be measured based on its current use when cessation of that use is imminent and an active programme to complete the planned change of use has been initiated;

(b) to avoid imposing a potential requirement to seek information about decisions made by senior levels of government but not yet communicated to the holder of the subject asset, added a qualifier in paragraph Aus29.2(d) that the condition would be triggered only if reasonably available information exists that it is met; and

(c) noted that being "highly probable that the current use of the asset will cease within one year" aligns with the text in paragraph 8 of AASB 5.

BC73 In making the decision noted in paragraph BC71(b), the Board noted that applying the condition in (ii) of the table in paragraph BC70 could result, inappropriately, in an asset being measured based on its original use when that use has ceased. For example, an asset might take several years to adapt for its alternative use. That alternative use might be the predominant source of benefits once cessation of the asset's current use is imminent, and would be the only source of benefits if the asset's original use has ceased (and its recommencement is unrealistic). The Board also noted the objective of AASB 5 for initially classifying an asset as 'held for sale' is to determine the point from which the asset's carrying amount will be recovered principally through a sale transaction rather than through continuing use (AASB 5 paragraph 6).

Transfers of assets

BC74 A stakeholder requested the Board to clarify whether the proposed conditions in (i)–(v) of the table in paragraph BC70 would apply to assets that will be transferred to another entity in neither a sale nor a distribution to owners. The Board considered that while the asset continues to be recognised (ie until transferred), the not-for-profit public sector entity is not required to consider whether the asset's highest and best use differs from its current use unless all conditions in paragraph Aus29.2 are met.

BC75 Another stakeholder requested the Board to clarify whether an entity is required to assess whether an asset's current use remains its highest and best use if the asset will be transferred to another entity in the same government and will be used for the same purpose as its current use, such as in a machinery of government transfer. The Board considered that, in the situation described by the stakeholder, an entity may determine that the asset's current use remains its highest and best use until the asset is transferred, which would occur if one or more conditions in paragraph Aus29.2 have not been met (eg if cessation of the asset's current use within one year of the measurement date is not (based on reasonably available information) highly probable and, therefore, paragraph Aus29.2(d) has not been met).

Other observation

BC76 The Board observed that paragraphs Aus29.1 and Aus29.2 provide guidance on conditions that must be met to potentially conclude that, regarding paragraph 29 of AASB 13, factors suggest that a different use by market participants (including other not-for-profit public sector entities) would maximise the value of the

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asset. However, meeting the conditions in paragraphs Aus29.1 and Aus29.2 for needing to consider whether an asset's highest and best use differs from its current use would not necessarily indicate that the asset's highest and best use differs from its current use (although such a conclusion would typically be reached). Once an asset meets the applicable conditions in paragraphs Aus29.1 and Aus29.2, the entity reassesses the asset's highest and best use – the outcome of which will depend on the facts and circumstances.

Appropriate level of management

BC77 Due to the unique characteristics of decision-making structures in the public sector, some stakeholders requested the Board to provide guidance on who might be the appropriate level of management of an entity for the purposes of applying paragraph Aus29.2(b). The Board considered that an entity needs to apply judgement in determining the appropriate level of management, which will depend on the facts and circumstances of individual assets. In this context, the appropriate level of management might depend on, for example, the asset's significance, the requirements (legislative and policy) and conventions for decision making in the public sector, and the resulting governance structure affecting the not-for-profit public sector entity.

BC78 The Board observed that typical examples of the appropriate level of management of an entity holding an asset not primarily for its ability to generate net cash inflows would include a local government council, the entity's chief executive officer and, where the entity is controlled by a government, the entity's responsible Minister or the Cabinet of that government.

BC79 It should be noted that if a non-financial asset's alternative use is identified as its highest and best use and the alternative use has a primary purpose of generating net cash inflows, the asset would subsequently be outside the scope of this Amending Standard.

Disclosure where the highest and best use of an asset differs from its current use (paragraph Aus93.2)

BC80 Paragraph 93(i) of AASB 13 includes the following disclosure requirement: "… for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use." Some ED respondents commented that there is uncertainty whether the proposed principle that the asset's current use is presumed to be its highest and best use unless rebutted under the ED's proposed criteria would also be applicable to the disclosure requirement in paragraph 93(i) of AASB 13. That is, the Board was advised of concern that the relief from having to search for nebulous possible higher and better uses of an asset might be negated if that relief does not apply to the requirements of paragraph 93(i) of AASB 13.

BC81 The Board noted that disclosures under paragraph 93(i) of AASB 13 would not be required unless the entity has determined that the asset's highest and best use differs from its current use. In addition, the Board concluded that an entity should be required to consider whether this difference exists only when, in accordance with paragraphs Aus29.1 and Aus29.2, at the measurement date the asset is classified as held for sale or held for distribution to owners in accordance with AASB 5 or it is highly probable that the asset will be used for an alternative purpose to its current use. For the avoidance of doubt, the Board decided to include paragraph Aus93.2 to make this explicit.

Financially feasible use (paragraph Aus28.1)

BC82 The Board was also asked to clarify the application of 'financially feasible use' in paragraph 28(c) of AASB 13 to non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, because those assets are not held primarily to produce an investment return. Paragraph 28(c) of AASB 13 refers to an asset's use that "generates adequate income or cash flows … to produce an investment return …".

BC83 The Board considered that modifying AASB 13 is necessary to avoid the risk that paragraph 28(c) of AASB 13 is interpreted to preclude measuring the fair value of a non-financial asset not held primarily for its ability to generate net cash inflows at an amount exceeding the present value of cash inflows generated directly by the asset. Such an interpretation could result in measurements that do not reflect faithfully the service potential embodied in those assets for which market participants would be prepared to pay in a hypothetical sale transaction. The Board noted that for many assets not held primarily for their ability to generate net cash inflows, their fair value would be measured at current replacement cost (under the cost approach), and although these assets often generate considerable cash inflows through 'indirect' sources, such as appropriations and grants, these cash inflows typically would not be included in assessments of 'investment returns' such as the cash inflows used in applying the income approach.

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BC84 In commenting on the ED and the Fatal-Flaw Review draft, a stakeholder expressed concern that the Board's proposed not-for-profit public sector entity guidance on the concept of financially feasible use in paragraph Aus28.1 would introduce non-financial influences into the concept of financial feasibility and significantly distort the meaning of that concept. The stakeholder requested clarification of the following questions related to the Board's proposed paragraph Aus28.1:

(a) if fair value is not a measure of an asset's capacity to generate an investment return, which benefits are to be measured under paragraph Aus28.1; and

(b) under paragraph Aus28.1, would there be any circumstances under which the income approach may be applied 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?

BC85 In response to the stakeholder's question noted in paragraphs BC84 (stem) and BC84(a), the Board observes that, for any fair value measurement, regardless of the nature of the entity, the concept of future economic benefits or service potential must reflect benefits for which market participant buyers would be prepared to pay for the subject asset. The Board considers that, if a not-for-profit market participant buyer would be willing to pay more for an asset, if necessary, than the amount reflecting the net cash inflows the asset could generate (which might occur if the subject asset (e.g. a specialised asset) is not available in the market for a price reflecting its cash-generating ability), measuring the asset at that higher amount would not introduce non-financial influences into the concept of financial feasibility. In such a case, hypothetical market participant buyers would be willing to pay a cash price for the asset exceeding the amount on which a commercial return may be generated, because of non-commercial benefits they can derive. If the subject asset is not available in the market for a price reflecting its cash-generating ability, and in the circumstances that asset is measured using the cost approach based on acquisition for its highest and best use (including deductions for any obsolescence), its fair value measurement would not involve non-financial influences, because paragraph B9 of AASB 13 stipulates that current replacement cost does not exceed the amount for which a market participant buyer could replace the asset's service capacity.

BC86 In response to the stakeholder's question noted in paragraph BC84(b), the Board observes that the modifications to AASB 13 set out in this Standard, including the modification of the guidance on 'financially feasible use' in paragraph Aus28.1, do not indicate that the income approach cannot be applied when measuring 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. The entity uses judgement in determining which valuation technique (or combination of techniques) to apply, considering all facts and circumstances and the availability of observable inputs relevant to the subject asset.

BC87 The stakeholder also requested the Board to provide illustrative examples of how to apply paragraph Aus28.1, including where the asset does, or does not, have the potential to derive income. The Board declined that request because:

(a) paragraph Aus28.1 proposes a simple amendment to replace:

  (i) assessing whether an asset's use would generate an investment return on an investment in that asset, with

  (ii) assessing whether market participants would be willing to invest in the asset's service capacity. This would be largely dependent on whether the asset provides essential (or highly desired) goods or services to beneficiaries of either the entity or a similar not-for-profit public sector market participant buyer hypothetically bidding for the asset, which typically would be the case for assets within the scope of this Amending Standard;

(b) the illustrative examples on IFRS 13 do not include illustrative examples on 'financially feasible use'; and

(c) neither (i) nor (ii) above involves estimating fair values (instead, 'financially feasible use' is a factor in developing fair value estimates).

BC88 The Board also observed that, where the market or income approach is used, there should be no change to how financially feasible use would be assessed in light of paragraph Aus28.1.

Interaction with functional obsolescence

BC89 During the outreach related to the Fatal-Flaw Review draft Standard, a stakeholder questioned the interaction between the proposed paragraph Aus28.1 and functional obsolescence. With the introduction of a new financially feasible use concept in proposed paragraph Aus28.1 focused, in part, on the cost of providing goods or services, the stakeholder commented it is unclear whether a subject asset having excess operating costs compared with a modern equivalent reference asset might cause:

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(a) the subject asset's current use to be considered financially infeasible after considering functional obsolescence; and

(b) if the subject asset is measured under the cost approach, the concept of functional obsolescence to be considered inapplicable because determining whether a use of the asset is 'financially feasible' has regard to the resulting cost of goods or services the asset provides and therefore the amount market participants would be willing to invest in the asset's service capacity.

BC90 Paragraph 80.6 of International Valuation Standard IVS 105 *Valuation Approaches and Methods* provides international valuation standards guidance on the two forms of functional obsolescence. It states:

> There are two forms of functional obsolescence:
>
> (a) excess capital cost, which can be caused by changes in design, materials of construction, technology or manufacturing techniques resulting in the availability of modern equivalent *assets* with lower capital costs than the subject *asset*, and
>
> (b) excess operating cost, which can be caused by improvements in design or excess capacity resulting in the availability of modern equivalent *assets* with lower operating costs than the subject *asset*.

BC91 To explain their concern, the stakeholder provided an example assuming that the subject asset (a building) has in-built halogen lights and the modern equivalent reference asset has in-built LED lights, which are more cost-effective to operate than halogen lights. In this case, paragraph 80.6(b) of IVS 105 would indicate the fair value of the subject asset should be adjusted down to reflect the excess operating costs compared with the modern equivalent asset used as a reference asset. The stakeholder requested the Board to clarify whether, if making such adjustments would result in a small estimated fair value, the asset's use could still be considered financially feasible under the new proposed paragraph Aus28.1, since it would require consideration of the cost of providing goods or services.

BC92 The Board noted that, under proposed paragraph Aus28.1, the cost of providing goods or services would be a consideration in determining whether market participants would be willing to invest in the asset's service capacity; the other consideration being the capability of the asset to be used to provide needed goods or services to beneficiaries.

BC93 Even if the subject asset is estimated to have a low fair value due to having higher operating costs than the modern equivalent reference asset, if it has been judged that market participants, including other not-for-profit public sector entities, would be willing to invest in the subject asset's service capacity considering also the capability of the asset to be used to provide needed goods or services to beneficiaries, then the asset's use would be considered financially feasible.

BC94 In addition, this Amending Standard would not modify the requirement in paragraph B9 of AASB 13 that, when the cost approach is applied, the asset's fair value measurement takes into account physical deterioration, functional (technological) obsolescence and economic (external) obsolescence. An asset's current replacement cost measured in accordance with paragraphs B8 and B9 of AASB 13 would be reduced by the effect of functional obsolescence because it reduces the amount market participant buyers would be willing to pay for the asset's service capacity.

BC95 If, for example, an asset is required by a not-for-profit public sector market participant buyer to provide needed goods or services, that market participant buyer would be willing to pay the necessary cost to acquire or construct the asset, but no more. In contrast, if a subject asset does not provide essential or highly desired goods or services, it might be concluded in the circumstances that the cost of acquiring or constructing the asset cannot be justified by a not-for-profit public sector market participant buyer. Depending on the other facts and circumstances, it might even be concluded that the only financially feasible use of the asset is to hold it for sale (this illustrates one of the reasons why, for assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows, the Board decided not to constrain the selection of the market approach, income approach or cost approach).

Aspects of highest and best use for which no additional guidance is warranted

Physically possible use

BC96 As stated in paragraph 22 of AASB 13, fair value measurement of an asset is based on the assumptions that market participants would use when pricing the asset. Specifically, when the presumption that an asset's current use is its highest and best use is rebutted, to identify the highest and best use of an asset, an entity

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takes into account the use of the asset that is physically possible, legally permissible and financially feasible.

BC97 Stakeholders requested guidance regarding whether, and if so how, physical constraints should be considered when measuring an asset's fair value. These physical constraints can be:

(a) naturally occurring, for example land under water (eg marine parks) and old growth forests (eg national parks), where both examples are of assets that are not readily replaceable or cannot be relocated to an alternative location; and

(b) the result of the entity's activities, for example:

(i) land that has been used as a council garbage tip, where the resulting risk of methane emissions might limit the land's potential uses to being suitable only for conversion to parkland; and

(ii) cemetery land, where the issue is not only the legal restriction for use as a cemetery but involves human remains that cannot be moved to another location should the entity be required to 'replace the service potential' embodied in the cemetery.

These physical constraints are discussed in paragraphs BC98–BC102.

Naturally occurring physical constraints

BC98 The Board concluded that a naturally occurring physical constraint leading to an inability in practice (rather than hypothetically) to replace or relocate the asset, such as a marine park, does not of itself preclude measuring the asset at fair value because a fair value measurement assumes a hypothetical transaction.

BC99 However, for some marine parks and old growth forests there might be insufficient market data available to enable reliable estimates of the asset's fair value. The Board noted that paragraph 31 of AASB 116 specifies that for an asset to be subsequently measured at a revalued amount, the fair value of the asset must be able to be measured reliably.

Physical constraints resulting from the entity's activities

BC100 The Board noted that some activities of the entity, such as using a parcel of land as a garbage tip, affect the physical characteristics of the asset that market participants would take into account when pricing the asset (eg using land as a garbage tip would limit the physically possible use of the land, as referred to in paragraph 28(a) of AASB 13).

BC101 In the case of cemetery land, even if the land were not legally restricted to being used only as a cemetery, the number of plots used for interred human remains would affect the cash-generating ability of the cemetery land because it reduces the number of remaining plots that a market participant could sell. This would be considered in measuring the fair value of cemetery land by reference, directly or indirectly, to the land's ability to generate net cash inflows or income.

BC102 The Board considered that any specific guidance regarding how physical constraints should be considered in estimating the fair value of an asset does not belong in principles-based Australian Accounting Standards.

Legally permissible use

BC103 Paragraph IE29 of the IASB's Illustrative Examples accompanying IFRS 13 (which can be accessed via the AASB's website) 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).

BC104 Consistent with the IASB's analysis in the illustrative example quoted in paragraph BC103, the Board noted that the fair value measurement of an asset:

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(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).

Prohibitions on sale

BC105 Paragraph 28(b) of AASB 13 is silent regarding whether prohibitions on the sale of an asset are to be considered in identifying an asset's highest and best use; that paragraph specifies only that certain restrictions on the *use* of the asset should be taken into account when identifying an asset's highest and best use. Some stakeholders requested guidance on the highest and best use of a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows that the entity is prohibited from selling, and how that prohibition should be taken into account in measuring the asset's fair value.

BC106 The Board noted that the fair value of an asset is based on a hypothetical sale transaction, notwithstanding any prohibition on the asset's sale. The restrictions taken into account when determining an asset's highest and best use are those that transfer upon the asset's sale to the hypothetical market participant. Therefore, a prohibition on sale of such an asset is not a factor in the determination of its highest and best use, and consequently should be disregarded when measuring the asset's fair value.

Legal restrictions on an asset's use

BC107 Some stakeholders requested guidance regarding restrictions relating to caveats attached to land, such as where biodiversity rights have been sold through a biodiversity scheme and the land cannot be used for another purpose. The Board considered that if the caveats would remain attached to the land upon its sale to a market participant, such caveats should be considered in identifying the asset's highest and best use.

'Implied restrictions' on an asset's use

BC108 Some stakeholders have informed the Board that sometimes a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows, although not subject to any legal restrictions, is subject to an 'implied restriction' limiting the asset's use to its current use – that is, where there is no legal restriction imposed on the asset but, because of social or political expectations or other factors, the not-for-profit public sector entity holding the asset would be unable to use the asset for an alternative use.

BC109 Those stakeholders consider that those assets with implied restrictions would never be sold by the entity holding them because of the legal mandates applying generally to the not-for-profit public sector entity. Therefore, they consider that the entity can use those assets only for their current use. They argued that implied restrictions over the use of an asset should be treated as substantially the same as legal restrictions referred to in paragraph 28(b) of AASB 13 in identifying the highest and best use of the asset when measuring the asset's fair value.

BC110 The Board decided that the general principles in AASB 13, as described in paragraph BC104, are sufficient in determining the highest and best use of an asset subject to implied restrictions – that is, the highest and best use of an asset takes into account physical characteristics of the asset that market participants would take into account when pricing the asset, and legal restrictions on use that would be transferred to market participants in a hypothetical sale transaction. In addition, the Board noted that the strict criteria in paragraphs Aus29.1 and Aus29.2 for considering whether to measure an asset based on an alternative use to its current use should restrict the circumstances in which the fair value of an asset with implied restrictions would be measured based on an alternative use.

Public-sector-specific legal restrictions on prices that can be charged

BC111 Consistent with the Board's view noted in paragraph BC104, if legal restrictions imposed on the prices that a not-for-profit public sector entity may charge for using an asset not held primarily for its ability to generate net cash inflows would not be transferred to market participants, those restrictions would not be considered in fair value measurement of the asset. The Board observed that, in various cases, such legal restrictions on prices that can be charged are entity-specific restrictions (ie restrictions that are not expected to transfer to market participant buyers).

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BC112 For example, a city council might provide car parking at below-market prices to provide enhanced access (and entice more visitors) to the city centre. Because a market participant buyer in a hypothetical sale of the city council's car park would not be restricted to providing car parking at below-market prices, it would price the city council's car park without regard to the discounts currently provided to patrons. Therefore, the fair value estimate of the car park should not be reduced (compared with the value determined for a for-profit entity) because of a self-imposed restriction to charge below-market prices for the use of car spaces.

When the current use of land and improvements on land might not be their highest and best use

BC113 A group of stakeholders asked the Board to clarify whether, in relation to land and improvements of a not-for-profit public sector entity not held primarily to generate net cash inflows, the fair value of improvements on land should be measured at nil if it has been concluded that the highest and best use of the land used jointly with improvements is different from its current use (to provide services to the community) and the highest and best use assumes the existing improvements on the land would be demolished. The Board noted that:

(a) the IASB considered this issue in the context of for-profit entities when developing IFRS 13 (see paragraphs BC115 and BC116); however,

(b) the IFRS Interpretations Committee issued an Agenda Decision *Valuation of biological assets using a residual method* in March 2013. The Agenda Decision concerned biological assets that are physically attached to land, which have no separate market value and are measured at fair value using a residual method. The Committee noted that "IFRS 13 does not explicitly address the accounting implications if those circumstances arise and the fair value measurement of the asset based on its highest and best use assumes that other assets in the group need to be converted or destroyed." The Committee also noted that this issue might affect the accounting for assets in the scope of Standards other than IAS 41 *Agriculture*, and for these reasons decided not to undertake a project to address this issue; and

(c) this issue is not specific to not-for-profit entities.

BC114 Therefore, the Board decided not to develop implementation guidance on this issue. In addition, the Board noted that, since receiving the stakeholder group's request for guidance noted in paragraph BC113, the Board developed conditions in paragraphs Aus29.1 and Aus29.2 that must be satisfied before potentially identifying a higher and better use of a non-financial asset not held primarily for its ability to generate net cash inflows – specifically, in various circumstances, those conditions might nullify the premise of the question that the assets' current use is not their highest and best use. For an alternative feasible use of land and buildings currently used for a community purpose to potentially be identified as the highest and best use of those assets (thus potentially implying that the buildings have a fair value of nil), it would be necessary to meet the criteria in paragraphs Aus29.1 and Aus29.2 for considering whether an asset's current use is not its highest and best use. If those criteria are met, the discussion in paragraphs BC115–BC119 would be relevant.

BC115 In relation to this issue generally, paragraphs BC72 and BC73 of the IASB's Basis for Conclusions for IFRS 13 use an example of a factory. Paragraph BC72 states that "The IASB concluded when developing the exposure draft [of IFRS 13] that measuring the factory at nil would not provide useful information when an entity is using that factory in its operations. In particular, users would want to see depreciation on that factory so that they could assess the economic resources consumed in generating cash flows from its operation." Prior to finalising IFRS 13, the IASB had exposed a proposed requirement for an entity to separate the fair value of the asset group into its current use and fair value components.

BC116 However, after considering responses from its stakeholders that preparing separate valuations for each asset in the group of assets would be costly, the IASB noted in paragraph BC73 of the IASB's Basis for Conclusions for IFRS 13 that "… when an entity uses a non-financial asset in a way that differs from its highest and best use (and that asset is measured at fair value), the entity must simply disclose that fact and why the asset is being used in a manner that differs from its highest and best use." That disclosure requirement is stated in IFRS 13 paragraph 93(i).

BC117 Therefore, when the highest and best use of land and improvements collectively within a group of assets of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is different from their current use by the entity (after applying the principle in paragraphs Aus29.1 and Aus29.2 that an entity is required to consider whether an alternative use of an asset is the asset's highest and best use only when either the asset is classified as held for sale or held for distribution to owners in accordance with AASB 5 or it is highly probable that the asset will be used for an alternative purpose), the entity would nonetheless conform to the general principle that each asset's fair value is based on its highest and best use

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(which may mean that the factory in the IASB's example would be measured at nil), but include a disclosure note explaining why the asset is being used in a manner that differs from its highest and best use, in accordance with paragraph 93(i) of AASB 13.

BC118 The Board noted that paragraph 31(a)(iii) of AASB 13 states that: "assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used." In relation to the question from the group of stakeholders noted in paragraph BC113, the Board noted a view that, consistent with paragraph 31(a)(iii) of AASB 13, it would be inappropriate for land and its improvements to have two different highest and best use assumptions if they are used in combination to maximise value to market participants.

BC119 The Board also noted that paragraph 17 of AASB 101 *Presentation of Financial Statements* states that to achieve a fair presentation of financial statements, an entity is required to "… provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance." The Board noted a view that, if an entity considers the current value of those improvements based on their current use and periodic depreciation is important to users of financial statements, it would consider whether it should disclose this information to comply with paragraph 17 of AASB 101.

Market participant assumptions about a non-financial asset not held primarily for its ability to generate net cash inflows (paragraphs F2–F7)

Market participants for the subject asset

BC120 Consistent with IFRS 13, when measuring the fair value of an asset under AASB 13, the objective is to estimate an exit price from the perspective of a market participant for the asset at the measurement date. Therefore, fair value assumes that a market participant's assumptions when pricing an asset are identifiable.

BC121 Some stakeholders expressed the view that, in some cases, a market participant for a non-financial asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is not readily identifiable. This is because the services provided by such an asset sometimes are unique; and therefore, they argued that:

(a) there would not be a private sector entity, another government or another not-for-profit public sector entity that would provide such services; and, in turn,

(b) there would not be another identifiable market participant for many assets held by not-for-profit public sector entities. Therefore, the market selling price of many such assets, or of identical assets, is unlikely to be directly observable.

BC122 The Board noted that paragraph 23 of AASB 13 states that an entity need not identify specific market participants, reflecting the focus of paragraph 22 of AASB 13 on the *assumptions* that market participants would use when pricing the asset. An entity estimates the pricing assumptions that other market participants (ie market participants other than the holder of the asset) would use by maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

BC123 The Board observed that many not-for-profit public sector entity assets not held primarily for their ability to generate net cash inflows are used in combination with other assets rather than on a stand-alone basis. As discussed in paragraphs BC54–BC55, the IASB noted in paragraphs BC78 and BC79 of its Basis for Conclusions on IFRS 13 that sometimes an observed market price – one for sale of an asset on a stand-alone basis – will not reflect an asset's fair value (because it does not reflect the value that the asset contributes to the entity, which is achieved by using the asset in combination with other assets). The IASB noted that fair value measurement for such an asset should assume that the market participant buyer steps into the shoes of the entity holding the subject asset.

BC124 Therefore, consistent with the IASB's view, the Board considered that when measuring the fair value of a non-financial asset of a not-for-profit public sector entity (the subject asset), market participants for the subject asset would include other not-for-profit public sector entities because they represent market participant buyers that hypothetically "step into the shoes" of the not-for-profit public sector entity holding the subject asset. That is, the entity considers the assumptions other not-for-profit public sector entities would use when pricing the subject asset. The Board observed that the majority of respondents to ED 320 who commented on this topic agreed with this view.

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Developing unobservable inputs (paragraphs F3–F7)

BC125 In light of the stakeholder comment that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are unique to the holder of the asset and another identifiable market participant for the asset would be unlikely to exist (ie the entity would be unlikely to find observable inputs for measuring the fair value of such unique assets), the Board considered that the holder of those assets would need to develop at least some unobservable inputs in order to measure the fair value of those assets.

BC126 In relation to developing unobservable inputs, paragraph 89 of AASB 13 states that:

> An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. 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). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. **Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement**. [emphasis added]

BC127 Paragraph 89 of AASB 13 permits the use of an entity's own data in developing unobservable inputs. In relation to applying the principle noted in paragraph BC122, the Board decided to add implementation guidance clarifying paragraph 89 of AASB 13 by:

(a) re-expressing the requirements of that paragraph, so that an entity's own assumptions are required to be used at 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;

(b) retaining the requirement for a not-for-profit public sector entity to adjust its own 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). This would preclude an entity from using its own unadjusted data where those data are inconsistent with reasonably available information about the inputs that other market participants (eg other not-for-profit public sector entities, such as other local governments) would use in pricing the asset; and

(c) replicating the statement in paragraph 89 of AASB 13 that an entity need not undertake exhaustive efforts to obtain information about other market participant assumptions.

BC128 In relation to paragraph BC127(b), the use of data about the inputs that other not-for-profit public sector market participants would use in pricing the asset is based on the hypothetical assumption that such market participants would acquire the not-for-profit public sector reporting entity's assets; it is not necessary that such an acquisition will actually occur. Where other not-for-profit public sector entities have comparable assets, information reasonably available to valuers about those assets enables valuers to assess whether other market participants would use different data from the entity's own data.

BC129 Adding paragraphs F5–F7 to AASB 13 is justified in accordance with paragraphs 24(a)(iii) and 30(h) of the *AASB Not-for-Profit Entity Standard-Setting Framework*, to reduce the potential for confusion regarding when the search for assumptions of other market participants ends, and in turn reduce the cost and effort required to identify which market participant assumptions to use in measuring the fair value of non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. This is because, unlike paragraph 89 of AASB 13, paragraphs F5 and F6 state that:

(a) if some data of other market participants to measure the fair value of an asset are not observable, the entity uses its own assumptions as a starting point and adjusts them to the extent that reasonably available information indicates that other market participants would use different data; and

(b) to the extent that relevant information about the assumptions of other market participants is not reasonably available, the entity would use its own data to estimate the fair value of the asset without the need to incur exhaustive efforts to identify other market participant data.

BC130 In addition, paragraphs F5–F7 should be clearer and more straight forward to apply than paragraph 89 of AASB 13 alone, by treating the reasonable availability of other market participant data as a criterion for amending the entity's own assumptions, thus stipulating a process with two distinct steps. Paragraph 89 of AASB 13 refers to an entity needing to take into account all information about market participant

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assumptions that is reasonably available, without indicating the sequence in which that information would be taken into account if an entity uses its own data as part of estimating an asset's fair value.

BC131 The Board noted that respondents to ED 320 generally supported the Board's proposed guidance, and decided to confirm that guidance with some editing for greater clarity.

BC132 The Board observed that some stakeholders commented that infrastructure (eg roads, drainage and sewerage works), parliament houses, fire stations, police stations, war memorials, traffic or pedestrian facilities, and community facilities (eg toilet blocks) are typical assets for which information about other market participant assumptions often would neither be reasonably available nor indicate that those assumptions differ from the entity's own assumptions. However, the Board concluded it will depend on the facts and circumstances of each non-financial asset whether it exhibits neither of these characteristics.

BC133 The Board also considered a request from ED 320 respondents for clarification of whether the proposed requirement to measure an asset's fair value using the entity's own assumptions as a starting point would apply on a whole-of-asset basis or on a per-input basis to a fair value estimate. The Board decided to clarify in paragraph F7 that, when some inputs to a fair value estimate are observable market data and other inputs are unobservable, the unobservable inputs would be used for part of the asset's fair value estimate. Paragraph F7 provides an example of a self-constructed specialised facility, the land component of which has comparable land with an observable market price. If entity-specific data are needed to measure the fair value of some or all of the improvements on that land, those entity-specific data would be included in the fair value estimate for the facility together with observable data about market participant assumptions for other components of the facility.

Specialised asset considerations

BC134 Since most stakeholders' requests for guidance on fair value measurement pertain to non-financial assets that either have limited market inputs, or are specialised, or both, the Board considered whether to provide guidance on identifying the market participant assumptions to use when measuring specialised assets only, rather than providing guidance more broadly on all non-financial assets not held primarily for their ability to generate net cash inflows.

BC135 The Board decided not to provide guidance limited to specialised assets because:

(a) the application of AASB 13 should not be based on the nature of the asset, in view of AASB 13 providing a fair value hierarchy focused on the nature and extent of observable inputs; and

(b) it would be difficult to clearly distinguish specialised assets from other assets.

Other considerations

BC136 The Board considered, but rejected, providing guidance on market participant assumptions based on whether a market participant other than the holder of the asset subject to measurement (the subject asset) is readily identifiable, and on identifying the entity likely to be the highest bidder for the subject asset in a hypothetical sale.

BC137 The Board made this decision after considering comments received from stakeholders in targeted outreach that many non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows are not sold regularly and may not have identifiable market participants other than the holder of the asset. Two main concerns were raised by stakeholders regarding the approach described in paragraph BC136, namely that:

(a) some assets might have multiple market participants, and requiring an entity to identify the likely highest bidder for an asset would impose greater costs in preparing and auditing financial statements; and

(b) it would be difficult to apply the concept of a hypothetical highest bidder for assets that are unlikely to be sold (eg because of a Government directive preventing an entity from selling the asset).

BC138 The Board concluded that re-expressing the requirements of paragraph 89 of AASB 13 in the manner described in paragraphs F5–F7 would address these two key concerns raised by stakeholders.

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Assumed location of an asset when applying the cost approach (paragraph F11(a))

BC139 This issue relates to an asset of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows and measured under the cost approach (eg a public school or public hospital). This issue mainly concerns the fair value measurement of real property.

BC140 The Board was asked to clarify whether the location of the real property being valued should necessarily be the property's existing location, particularly in view of the principle that an asset's current replacement cost reflects replacement in the most economical manner. For example, if a facility could deliver its services equally well in a nearby location with cheaper land, the Board was asked whether it be assumed that "the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility" (as referred to in paragraph B9 of AASB 13) reflects the price of the facility in the cheaper location.

BC141 For the reasons described in paragraph BC155, a fair value estimate is based on an assumed hypothetical exchange transaction by considering data about a reference asset. Some stakeholders argued that the facility's fair value estimate should reflect the price of suitable property in a cheaper feasible location (the arguably suitable reference property) because a market participant buyer would not be willing to pay for an asset at a more expensive location, if the facility could deliver its services equally well in a nearby location with cheaper land. They argued that applying the generally accepted principle that an asset's current replacement cost is measured on an optimised basis typically by reference to the price of a modern equivalent asset, the modern equivalent asset would be a nearby asset in a cheaper location.

BC142 These stakeholders argued that the market value premium of property in its existing location over a suitable alternative location is a commercial element superfluous to the entity's not-for-profit (service delivery) objectives. They note that their view is consistent with the following text of The Royal Institution of Chartered Surveyors' Guidance Note *Depreciated replacement cost method of valuation for financial reporting* (November 2018):[1]

> Although the ultimate objective of the DRC method is to produce a valuation of the actual property in its actual location, the initial stage of estimating the gross replacement cost should reflect the cost of a site suitable for a modern equivalent facility. While this may be a site of a similar size and in a similar location to the actual site, if the actual site is clearly one that a prudent buyer would no longer consider appropriate because it would be commercially wasteful or would be an inappropriate use of resources, the modern equivalent site is assumed to have the appropriate characteristics to deliver the required service potential. The fundamental principle is that the hypothetical buyer for a modern equivalent asset would purchase the least expensive site that would realistically be suitable and appropriate for its proposed operations and the envisaged modern equivalent facility. … (paragraph 7.1)
>
> … An example could be a hospital that was originally constructed in the centre of a city that might now be better situated in the suburbs because of changes in the transport infrastructure or in the migration of the population it served. (paragraph 7.2)

BC143 In contrast, some other stakeholders argued that the current replacement cost of real property should always reflect the property's existing location, rather than the price of land in a cheaper feasible site. This is because the land's characteristics include its location, and the price premium for the existing site (compared with a cheaper feasible site) could be realised through sale and reinvested in other assets used to provide services. For example, the Application Guidance included in the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17 *Property, Plant and Equipment* states that:

> If depreciated replacement cost is used to measure the fair value of property, plant and equipment: (a) The value of the land shall reflect the fair value of the actual land held, in terms of both its size and location; … (paragraph AG2)
>
> In instances where land is underutilised, the fair value of the land shall be determined by reference to the highest and best use of such land. For example, in a case where specialised facilities are located in a prime central business district site but the operation would be able to run from a smaller sized and/or less valuable alternative site offering the same service potential, the fair value of the land would be the market value of the entire central business district-located site. (paragraph AG9)

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1 This Guidance Note is not explicitly identified as applying to fair value measurements, or non-fair value measurements, using depreciated replacement cost. However, paragraphs 2.1 and 2.2 of the Guidance Note refer to depreciated replacement cost being used in relation to the 'cost approach' to valuation, and to the market and income approaches as the other principal approaches to valuation, implying the Guidance Note would be relevant to fair value measurements (even if not exclusively).

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BC144 Similarly, some stakeholders argued that, from the perspective of market participants, the property in a more expensive location provides superior services. For example, an office space in a central business district location provides greater service capacity than office space in an inner suburb by having greater proximity to stakeholders and urban infrastructure, and by assisting the entity to attract and retain staff. These stakeholders are also of the view that if the property's service capacity can be relocated to another location, then the highest and best use of the current property is not limited to its existing use; and therefore, should be valued at its current location, reflecting its highest and best use.

BC145 Having regard to these conflicting views, the Board noted that it could theoretically be argued that the current replacement cost of an item of real property of a not-for-profit public sector entity should be measured as follows:

(a) if the real property needs to remain in its existing location due to legal restrictions or operational requirements, the property's current replacement cost should be based on replacement in the existing location; and

(b) if the real property does not need to remain in its existing location, the property's current replacement cost should be measured in the location that results in the higher of the following measures:

(i) the price a market participant would be prepared to pay to remove the improvements and then sell the property as a vacant site for an alternative use – reflecting the property's existing location. This is because an asset's fair value can never be less than the price for which that asset could be sold at the measurement date (excluding transaction costs); and

(ii) the price a market participant would be prepared to pay to replace the service capacity of the land and improvements in their existing use in the most economical manner. This amount would include the market price of land in the cheapest legally permissible location compatible with the entity's operational requirements for the facility. This is because, as an alternative to purchasing the asset subject to measurement, a market participant would build a modern equivalent property in an alternative site, if it would be cheaper than purchasing the asset in its existing location.

BC146 However, on further deliberation, the Board observed that the approach described in paragraph BC145 would have the following disadvantages:

(a) it is inconsistent with the view, which the Board supports, that the current replacement cost of real property should always be measured in its existing location because the service capacity of a property being replaced is the sum of:

(i) its capacity to provide services in its current use; and

(ii) its residual value (the present value of the net cash inflows from sale of the property at the end of the useful life of the improvements on the land), including the subsequent sale of the land component of the property (at its existing location). An asset's residual value contributes to the entity's capacity to provide services (and thus, indirectly, is another component of the existing asset's service capacity);

(b) it is unnecessarily complex. It would generally be very difficult to identify which location, of a potential variety of alternative locations with possibly significantly different market prices of land, might be used as the assumed alternative location; and

(c) it would be time-consuming and costly for preparers and auditors of financial statements. The additional cost of potentially preparing multiple valuations and due diligence assessments would be unlikely to be justified by the benefits to users of the financial statements.

BC147 In light of the concerns in paragraph BC146, the Board concluded that the current replacement cost of an asset, including real property, of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows should be measured by assuming the asset is replaced in its existing location, even if it would be feasible to relocate the asset to a cheaper location. The Board noted that respondents to ED 320 strongly supported the Board's view, and decided to add paragraph F11(a) to Appendix F of AASB 13.

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Nature of costs included in current replacement cost (paragraphs F8–F15)

BC148 The Board was asked to clarify which costs should be included in the current replacement cost of an asset held by a not-for-profit public sector entity when applying the cost approach under paragraphs B8–B9 of AASB 13, particularly where such an asset is constructed by or on behalf of the entity (ie not replaced in a single transaction). Specifically, stakeholders requested the Board to clarify whether the following costs should (among other costs) be included in the current replacement cost of the asset subject to measurement (the subject asset):

(a) costs of parts of an asset not expected to actually be replaced in the future, because they are not expected to wear out, but that would need to be incurred in a hypothetical acquisition or construction of the subject asset by a market participant buyer;

(b) site preparation costs, including costs of removal and disposal of unwanted existing structures on land; and

(c) intrinsically linked disruption costs, including costs of restoring another entity's asset that would be disrupted in a hypothetical replacement of the subject asset (the nature of disruption costs is explained in paragraph BC179).

BC149 Stakeholders also requested the Board to clarify, when identifying the component costs to include in an asset's current replacement cost, whether it should always be assumed that the asset would be replaced in the most economical manner, even if the entity would, in its ordinary course of operations, be required to incur additional costs.

BC150 The majority of respondents to ED 320 expressed in-principle support for most of the proposed implementation guidance on the nature of the costs to include in the current replacement cost of an asset, but also expressed concerns about the practical challenges of applying that proposed guidance. The Board considered the feedback and revised the guidance to address those concerns.

BC151 In particular, the Board observed that respondents' concerns about the difficulty of identifying and measuring some costs are mainly related to assets within the scope of the guidance in paragraph 89 of AASB 13 – when the market selling price of a comparable asset and at least some other market participant data are not observable. The Board added paragraph F5 to require an entity to use its own assumptions as a starting point and adjust them only to the extent that reasonably available information indicates that other market participants would use different data. In addition, the Board decided to provide a practical expedient in paragraph F14 whereby an entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraph BC148, provided that the entity includes all such costs for which data are reasonably available.

BC152 The Board also considered the feedback that identifying an asset's current replacement cost as including the costs referred to in paragraph BC148 might require an entity to recognise and measure separately some assets at a considerably more disaggregated level, resulting in increased cost and effort. For example, concerns were expressed that greater disaggregation might become necessary for costs to restore assets of other entities disturbed upon replacement of the subject asset, because those restoration costs would vary considerably according to location-specific factors. The Board observed that the implementation guidance on the application of the cost approach does not preclude the use of unit rates or standard costing methodologies that approximate the total amounts of individual assets, particularly in applying the concept of materiality. Similarly, the implementation guidance does not mandate the unit of account for assets measured at fair value by applying the cost approach.

The overarching principle

BC153 The definition of fair value in paragraph 9 of AASB 13 refers to the price that would be received to *sell* an asset (ie exit price). However, when the best evidence of a subject asset's fair value (maximising the use of relevant observable inputs) is not data about that asset's selling price or net cash inflows from use (and therefore the cost approach is applied), the asset's fair value is derived by regard to the asset's market *buying price* (often the sum of a number of purchase prices for the asset's parts). In relation to applying the cost approach, paragraph B9 of AASB 13 states that: "From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset."

BC154 In this regard, the price a market participant buyer would be prepared to pay for a subject asset is estimated by reflecting the fact that the market participant buyer presently does not possess the subject asset and needs

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to acquire or construct it in its entirety. The Board concluded that, to estimate this amount, an entity would include all necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date. This is because a market participant buyer of the subject asset would need to incur all those costs if it acquired or constructed the subject asset at the measurement date, whether that buyer hypothetically acquires the subject asset from the entity or constructs a substitute asset itself.

BC155 Because the subject asset is held by the reporting entity at the measurement date, an actual sale of the subject asset by the reporting entity to a market participant buyer did not occur on the measurement date. Consequently, as noted in IFRS 13 paragraph BC30, the definition of fair value assumes a hypothetical exchange transaction. Assuming a hypothetical acquisition or construction of a substitute asset by the market participant buyer requires the consideration of data about a reference asset. Therefore, an estimate of an asset's current replacement cost includes all necessary costs intrinsically linked to hypothetically acquiring or constructing a *reference asset* at the measurement date. The process of identifying and using data about reference assets, while maximising the use of relevant observable inputs and minimising the use of unobservable inputs, is discussed in paragraphs BC157–BC161.

BC156 ED 320 proposed the concept of "assuming the subject asset presently does not exist" as the overarching principle of the cost approach. The Board proposed that assumption as 'shorthand' for the principle that the market participant buyer presently does not possess the subject asset and needs to acquire that asset in its entirety. However, a few respondents commented that the concept that the subject asset presently does not exist conflicts with the proposed requirements to include certain asset-specific costs in current replacement cost. The Board decided not to state an overarching principle for the cost approach in the implementation guidance because paragraphs B8 and B9 clearly state that the cost approach reflects the amount that would be required currently to replace the service capacity of an asset, which requires all necessary costs intrinsically linked to the hypothetical acquisition or replacement of a reference asset to be included in the subject asset's current replacement cost.

Reference assets

BC157 The Board noted that, consistent with International Valuation Standard IVS 105 (effective 31 January 2022), measuring the fair value of an asset applying the cost approach generally requires an entity to:

(a) estimate the replacement cost of a reference asset as input; and

(b) adjust that estimated replacement cost of a reference asset for:

(i) any differences between the current service capacity of the reference asset and the subject asset; and

(ii) any obsolescence.

BC158 IVS 105 mentions that a reference asset could be a modern equivalent asset or a replica asset. Paragraph 70.5 of IVS 105 describes a modern equivalent asset as an asset "… that provides similar function and equivalent utility to the asset being valued, but which is of a current design and constructed or made using current cost-effective materials and techniques."

BC159 Paragraph 70.6 of IVS 105 states that using the reproduction cost method (ie the reference asset is a replica of the subject asset) to measure the value of the subject asset is appropriate in circumstances such as the following:

(a) the cost of a modern equivalent asset is greater than the cost of recreating a replica of the subject asset; or

(b) the utility offered by the subject asset could be provided only by a replica rather than a modern equivalent.

BC160 Some respondents to ED 320 argued that the implementation guidance should stipulate that a modern equivalent asset should be used as a reference asset only where a replica of the subject asset is unavailable. The Board disagreed with that suggestion because:

(a) if the current service capacity of an asset can be replaced more economically by a modern equivalent asset, it would be unlikely that a market participant buyer would be willing to pay the higher cost of a replica; and

(b) it would make AASB 13 more restrictive than IVS 105 and thus provide guidance on matters relating to detailed valuation assessments, which does not belong within the scope of an Australian Accounting Standard.

BC161 A few ED respondents argued that, for heritage assets held for their heritage significance, their replacement cost should be based on replication of the original heritage design but using modern cost-effective materials

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and processes (which are aspects of a modern equivalent asset). The Board agreed with that argument and added implementation guidance to that effect in paragraph F15.

Costs of parts of assets that will not actually require replacement

BC162 The Board was requested to provide guidance on whether an asset's current replacement cost should exclude costs of any parts of the asset that will not actually require replacement in the future because their service capacity does not expire over time (ie 'once-only costs'). This issue has been the subject of debate and inconsistent practice (for example, the current replacement cost of some roads has been estimated by excluding the cost of design work, earthworks and formation costs because those components do not wear out or become otherwise obsolete, and therefore do not require replacement in the future).

BC163 The Board concluded it would be inappropriate to exclude any costs from an estimate of an asset's current replacement cost on the grounds that they relate to parts of an asset that are not expected to actually be replaced in the future. For the reasons described in paragraphs BC153–BC155, an estimate of an asset's current replacement cost should include all necessary costs intrinsically linked to hypothetically acquiring or constructing a reference asset at the measurement date, reflecting that the hypothetical acquisition or construction costs are incurred by a market participant buyer that does not possess the subject asset at the measurement date.

BC164 Current replacement cost assumes hypothetical replacement or reconstruction of a reference asset, and is not limited to costs of replacements the entity expects to incur in the future (which is a matter of budgeting rather than measurement of existing resources). To exclude any costs from an estimate of an asset's current replacement cost on the grounds that they relate to parts of an asset that are not expected to actually be replaced in the future would imply that the fair value of an asset measured under the cost approach would be zero if, at the measurement date, the holder of the asset expects the asset neither to be replaced at the end of its useful life nor to have components replaced during its remaining useful life.

BC165 One respondent to ED 320 and some other stakeholders requested clarification of the 'starting point' for identifying once-only costs. For example, they commented that the 'starting point' that should be the focus of measuring the current replacement cost of parts of an asset could be the conditions prevailing at the site of the subject asset when it was initially acquired or constructed (but with the resulting costs measured using prices current at the measurement date), a vacant site with all site preparation works completed, or some other as-yet undefined point.

BC166 The Board considers that this question has conceptual and practical dimensions. From a conceptual viewpoint, paragraphs B8 and B9 of AASB 13 state that the cost approach to measuring an asset's fair value reflects the amount that would be required *currently* to replace the asset's service capacity. Therefore, in concept, the 'starting point' for considering the costs to include in an asset's current replacement cost is the current conditions (including market conditions and current operating environment) of the subject asset at the measurement date, estimated using a reference asset as input.

BC167 From a practical viewpoint, the entity might have limited information about some of the costs required currently to replace the service capacity of a reference asset. Although some costs to acquire or construct parts of an asset often have industry-wide data available to assist their estimation (eg costs of drainage pipes), some other parts of assets have costs that tend to be site-specific, and it may be necessary to use historical data retained by the holder of the subject asset. This can present practical difficulties, especially for costs of any parts that have not been incurred in recent years.

BC168 The Board concluded that an entity should not need to undertake exhaustive efforts to obtain information about the costs composing an asset's current replacement cost; however, an entity includes all such costs for which data are reasonably available. That is, under paragraph F14, if data about certain costs of some parts of an asset are not reasonably available, those costs would be omitted from an estimate of the subject asset's current replacement cost. However, those costs are not omitted simply because they relate to parts of an asset that are not expected to actually be replaced in the future.

Site preparation costs

BC169 Entities would need to apply judgement in the circumstances of the subject asset to determine the necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date. For an asset fixed to a parcel of land, this would include whether it would be necessary for the market participant to incur site preparation costs in order to hypothetically construct a reference asset at the subject asset's location.

BC170 For example, to measure the current replacement cost of a building, an entity would consider whether a market participant buyer would be able to acquire a vacant site in the area surrounding the existing location. If suitable vacant sites are available, market participants would be unlikely to pay for the current cost to

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demolish existing structures on the site (and, therefore, it would be unlikely that such a cost would be considered 'necessarily incurred'). Similarly, if market participants are able to acquire a suitable parcel of land with an existing structure that they could modify as necessary to create a modern equivalent of the subject asset, it would be unnecessary to remove and dispose of existing structures on the reference parcel of land. If there are no suitable alternative sites for a particular facility because the facility must be sited in its existing location, market participant buyers would be prepared to pay the location-specific costs of site preparation for that facility.

BC171 The costs included in an asset's current replacement cost, as a measure of the amount a market participant buyer would be prepared to pay for the asset, represent the costs avoided by a market participant buyer as a result of the entity possessing the service capacity embodied in the subject asset. Consistent with the related comment in paragraph B9 of AASB 13, the market participant buyer is prepared to pay the current amount of those costs avoided, and no more. For example, if:

(a) instead of acquiring the subject asset, a market participant buyer would have no choice but to incur costs to remove and dispose of unwanted existing structures on land as part of the costs to construct an asset with service capacity equivalent to that of the subject asset (because of a lack of suitable vacant sites at the measurement date); and

(b) the subject asset (land or improvements, or both) does not have any of those unwanted structures (either because the entity removed them or they never existed) and therefore acquiring the subject asset would save a market participant buyer from incurring those removal and disposal costs,

those costs to remove and dispose of unwanted existing structures on land would be included in the subject asset's current replacement cost.

BC172 Where the conditions in paragraphs BC171(a) and (b) are satisfied, the costs to remove and dispose of unwanted existing structures on land would be those of the typical market participant buyer. However, in accordance with paragraphs F5, F6 and F14, in the absence of reasonably available observable data about the costs saved by the market participant buyer, the entity would use its own assumptions about the removal costs it would incur if, hypothetically, those unwanted structures existed.

BC173 Some ED respondents commented that the fair value of the land on which the subject asset is fixed would, in some cases, reflect the fact that it is fit-for-purpose for the subject asset; and therefore, any hypothetical site preparation costs should be excluded from the estimated current replacement cost of fixed improvements on that land to avoid double-counting the site preparation costs. The Board included guidance on this issue in paragraph F12(c). An entity may need to apply judgement to determine whether necessarily incurred site preparation costs are reflected (explicitly or implicitly) in the fair value measurement of a subject parcel of land; where it is unclear whether this is the case, an entity might deem that such costs are reflected in the fair value measurement of the subject parcel of land and therefore exclude those costs from the current replacement cost of the subject asset fixed to the land.

BC174 A stakeholder provided comment on the circumstance described for Jurisdiction B of Illustrative Example 4 – where the entity incurred costs to level the subject site prior to constructing a facility on the site, but available land in the proximity of the subject site was level. The example concluded that a market participant buyer could hypothetically purchase a level site and therefore the levelling costs should not be included in the current replacement cost of the subject facility. The stakeholder was concerned that, if an entity had incurred site levelling costs (that were capitalised in the facility's carrying amount), but in a subsequent measurement of the facility, site levelling costs are excluded from the current replacement cost of the subject facility, the reduction in the asset's value would misleadingly indicate that the entity had made an economically unjustified decision in incurring the site levelling costs.

BC175 In respect of the stakeholder's concern noted in paragraph BC174, the Board was informed by some stakeholders that, in many cases, if the market approach is applied to measure the value of the land under a facility, any site preparation works incurred would be reflected in the land's market value. In those cases, the aggregate fair value measurement of the land and facility would not indicate that the necessarily incurred site preparation costs are economically unjustified. The particular outcome in Scenario B of Illustrative Example 4 reflects a simplified assumption (ie that the value created by site preparation works affects the improvements rather than the land). Illustrative examples are included to illustrate particular aspects and considerations, rather than provide a template for the treatment of particular fact patterns. As noted in paragraph IE1, the evaluations in each illustrative example are not intended to represent the only manner in which AASB 13 could be applied.

BC176 Some stakeholders commented that the treatment of costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct a reference asset at the measurement date should be consistent with the treatment of costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located (paragraph 16 of AASB 116 identifies this latter type of costs as part of the cost of an item of property, plant and equipment). Those stakeholders commented that if there is

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no present obligation for an entity to incur costs to remove and dispose of unwanted existing structures on land in order to hypothetically construct the subject asset at the measurement date, such costs should not be included in an asset's current replacement cost. Some other stakeholders asked for clarification of the relationship between those costs and the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located.

BC177 The Board observed that, in contrast with costs to remove and dispose of unwanted existing structures on land, the costs of dismantling and removing an item of property, plant and equipment and restoring the site on which it is located are end-of-economic-life costs. Those latter costs would not merit inclusion in the asset's current replacement cost because the market participant buyer of the subject asset logically would not pay for those costs, which in turn is because possessing the subject asset would not save the market participant buyer from having to incur those end-of-economic-life costs.

BC178 However, the Board also observed that Illustrative Example 2 accompanying AASB Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* states that, if an asset's valuation does not include an amount for these end-of-economic-life costs for which the entity has recognised a provision, the carrying amount of the asset will need to be adjusted by adding back an appropriate amount for the provision (Interpretation 1 paragraph IE7(b)). The IFRS Interpretation Committee's Basis for Conclusions on the IFRS Interpretation adopted as AASB Interpretation 1 states that the provision is accounted for separately from the valuation of the asset to ensure it is not counted twice (paragraph BC25(a)).

Disruption costs, including costs to restore another entity's assets

BC179 The Board was asked to clarify whether the subject asset's current replacement cost should include the cost to restore another entity's asset that would be disrupted during the hypothetical construction of the subject asset (eg drainage works of another entity disrupted when replacing a road). The Board decided to develop proposed guidance on such restoration costs and other disruption costs arising upon the hypothetical construction of the subject asset; those costs are collectively termed 'disruption costs' in paragraph F12 and this section of the Basis for Conclusions. Examples of disruption costs other than costs of restoring another entity's assets are costs of directing and diverting traffic (including the hire of safety barriers) and costs of employing safety officers.

BC180 The key principle underpinning the inclusion of disruption costs (including, but not limited to, costs to restore another entity's assets that would be disrupted during the hypothetical construction of the subject asset) in the current replacement cost of a subject asset is that, as discussed in paragraph BC154, to reflect the pricing assumptions of market participants, a subject asset's current replacement cost includes all necessary costs intrinsically linked to acquiring or constructing that asset at the measurement date.

BC181 The Board considered the following comments expressed by some stakeholders that it would be inappropriate to include the cost to restore another entity's asset in the current replacement cost of an asset held by the entity:

(a) because the entity does not control the other entity's asset that is being restored, it would be inappropriate to include in the measurement of the subject asset costs relating to the asset that would be restored;

(b) if the entity did not incur those costs when the subject asset was initially constructed, or if those disrupted assets did not exist when the subject asset was initially constructed. This is because including such restoration costs would increase the subject asset's fair value simply because of a change in the asset's operating environment (without the entity having improved the asset's service capacity), which would not faithfully represent the entity's performance; and

(c) if the other entity is within the same consolidated group as the holder of the subject asset, including those costs would result in double counting the restoration costs in the consolidated financial statements for the group. This is because the consolidated financial statements would include both of the following costs used under the cost approach:

(i) the current replacement cost of the disrupted asset of the other entity; and

(ii) the current replacement cost of the subject asset, including the costs to restore the other entity's asset.

BC182 In relation to the concern noted in paragraph BC181(a), the Board regards such restoration costs as costs of obtaining access to the service capacity embodied in the entity's subject asset. The Board noted that such costs restore, rather than enhance, the disrupted asset and, accordingly, are confined to the consequences of acquiring or replacing the entity's subject asset.

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BC183 In relation to the concern noted in paragraph BC181(b) about recognition of an increase in an asset's fair value without the entity incurring a related cost (and therefore a gain being recognised), the Board noted that these increases are examples of various increases in the market buying prices of components of assets that continue to be held by the entity and do not involve a related cost to the entity. The Board considered that a market participant would be willing to pay more for an asset due to the change in the asset's operating environment, despite the asset's service capacity to produce outputs not having improved. This is because all costs to restore another entity's asset would necessarily be incurred by a market participant if it were to acquire or construct the subject asset at the measurement date. Those additional restoration costs are necessarily incurred to obtain access to the services the subject asset is expected to generate. Similarly, a market participant would consider the costs currently avoided by possessing the subject asset; these costs are not limited to those already incurred by the entity or to restoration costs that would have been incurred to initially acquire or construct the asset.

BC184 The Board agrees with the concern noted in paragraph BC181(c) that the consolidated financial statements of the group to which the entity belongs would be overstated if both the disrupted asset and the subject asset are measured at their current replacement cost and included in the consolidated financial statements. Therefore, the Board decided that the current replacement cost of the subject asset should exclude any costs that hypothetically would be incurred to restore assets of an entity within the same consolidated group as the holder of the subject asset.

BC185 In reaching that decision noted in paragraph BC184 about the double-counting issue described in paragraph BC181(c), the Board considered whether, instead, it would be appropriate to exclude such restoration costs from current replacement cost, on the grounds of simplicity, for all non-financial assets of not-for-profit public sector entities not held primarily for their ability to generate net cash inflows. However, the Board decided against this approach because feedback from some stakeholders (in particular, local governments) supported including restoration costs for another entity's assets – consistent with local governments not being identified as entities included in a group of entities that prepares consolidated financial statements.

BC186 The Board acknowledged that the proposed exclusion of such restoration costs for assets of entities within the consolidated group to which the holder of the subject asset belongs would depart from the conceptual principle that an individual entity's assets are accounted for by reflecting the entity's perspective (rather than the perspective of the group). The Board considered that a more conceptual variation of the approach noted in paragraph BC184 would be to provide guidance that such restoration costs are included in an individual entity's financial statements where the entity is part of a group of entities that prepares consolidated financial statements, but eliminated on consolidation. However, in view of the cost involved in tracking such restoration costs at each measurement date, only to omit those restoration costs from the consolidated financial statements for the group, the Board considers that the costs of applying that more conceptual variation would be likely to outweigh the benefits of that approach.

BC187 Paragraph F12(a) does not require including in the subject asset's current replacement cost any costs to restore other assets of the same entity that would be disrupted in a hypothetical construction of the subject asset. This is because including those costs would double count them in fair value measurements of the entity's assets. If those other assets controlled by the entity are measured under the cost approach, their current replacement cost would include all costs of constructing them (or paying another entity to construct them) in their entirety. Therefore, the sum of the current replacement costs of each of the entity's assets should exclude any restoration costs relating to the entity's own assets.

Whether calibration is needed

BC188 In relation to including in the current replacement cost of a subject asset restoration costs of another entity's assets that were not incurred on initial acquisition of the subject asset (see paragraph BC181(b)), one stakeholder requested the Board to clarify whether including in an asset's current replacement cost any costs not yet actually incurred by the entity (and therefore resulting in a higher fair value of the asset compared with the initial capitalisation of cost) would require the application of the 'calibration' techniques referred to in paragraph 64 of AASB 13. The stakeholder commented that, if calibration were required, the estimate of an asset's current replacement cost would be calibrated in such a manner that the estimate reflects actual transaction prices (ie excludes any cost components not yet incurred by the entity, such as those hypothetical costs to restore another entity's assets described above). Paragraph 64 of AASB 13 states that:

> If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset … that is not captured by

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the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset …) at the measurement date.

BC189 The Board considered the suggestion in paragraph BC188 and decided not to require estimates of a non-financial asset's current replacement cost to be restricted to actual transactions, as an application of paragraph 64 of AASB 13. This is because:

(a) the Board considers that many inputs to estimates of the current cost of restoring another entity's asset (eg current unit costs, including costs of labour and materials) are likely to be observable, whereas paragraph 64 of AASB 13 applies to valuation techniques that use unobservable inputs; and

(b) using costs of restoration work yet to be incurred involves neither of the circumstances specifically mentioned in paragraph 64 of AASB 13, namely:

(i) calibration being necessary to ensure the fair value estimate reflects current market conditions; and

(ii) the valuation technique does not capture a characteristic of the asset.

BC190 In relation to paragraph BC189(b), the Board noted that paragraphs BC143–BC146 of the IASB's Basis for Conclusions on IFRS 13 indicate that the valuation adjustments involving calibration relate to measurement uncertainty, mainly in respect of financial assets and liabilities. The two circumstances identified in IASB paragraph BC145 that are not confined to financial assets and liabilities are where:

(a) calibration is necessary to capture a characteristic of the asset or liability; and

(b) measurement uncertainty has arisen from a significant decrease in the volume or level of market activity for the asset or liability.

BC191 The Board considers that neither of the circumstances referred to in paragraph BC190 seems particularly applicable to the treatment of restoration costs yet to be incurred by the entity at the measurement date.

Piecemeal replacement

BC192 Some ED respondents commented that, in some cases, an actual replacement of an asset is undertaken in different phases (ie a part of an asset rather than the whole asset is replaced) and asked whether, when developing unobservable inputs using its own assumptions in accordance with paragraph 89 of AASB 13, the entity should assume the asset will be replaced on a piecemeal basis or in its entirety. The Board concluded that using data of replacing an asset on a piecemeal basis might not be fully consistent with the objective of a fair value measurement under the cost approach. This is because a market participant buyer needing to acquire or construct an asset in its entirety would not need to incur additional costs that arise from replacing an existing asset on a piecemeal basis (such as security costs incurred to provide continuity of service delivery), nor would it logically be willing to pay the holder of the subject asset for incurring those additional costs.

BC193 The guidance in paragraph F14 that an entity need not undertake exhaustive efforts to obtain information about the costs referred to in paragraphs F12 and F13, provided that the entity includes all such costs for which data are reasonably available, should address concerns about practical difficulties of measuring the current cost to hypothetically replace an asset in its entirety if the asset's parts are actually replaced on a piecemeal basis. Where specific additional costs arising from piecemeal replacement are identifiable, they can readily be excluded from the estimate of the asset's current replacement cost. Where it is unclear whether some 'piecemeal costs' would differ if incurred as part of an entire replacement, when paragraph F5 applies, applying its principle to use the entity's own assumptions as a starting point and adjust them only to the extent that reasonably available information indicates that other market participants would use different data, would generally mean that the entity's own costs would be used, thus overcoming the practical difficulty of estimating the cost to hypothetically replace an asset in its entirety.

The most economical manner of hypothetical replacement

BC194 Application of the cost approach assumes implicitly a hypothetical acquisition or construction of the subject asset occurs in the most economical manner. However, stakeholders informed the Board that in many cases, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs in order to maintain an adequate quality of services to the public or to adhere to unlegislated Government policies that direct or limit replacement options, eg in relation to Australian industry content or security. Where the entity or another market participant replaces an asset, and it would necessarily incur greater costs

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than the cheapest legally permitted costs, the more expensive costs would be those most likely to be included in the pricing assumptions of the market participant and to be incurred in the ordinary course of operations. This view was included in ED 320 and was supported by a majority of respondents.

BC195 Therefore, the Board decided to include an illustrative example (Example 3) illustrating that, when paragraphs F5 and F11(b) apply, the entity estimates the cost currently required for a market participant buyer to acquire or construct a reference asset by using its own assumptions as a starting point and adjusting those assumptions to the extent that reasonably available information indicates that other market participants would use different data. Where, for the reasons noted in paragraph BC194, not-for-profit public sector entities would incur costs additional to the cheapest legally permitted costs, typically those additional costs would be included in the measurement of the asset's current replacement cost because there would not be reasonably available information indicating that other market participants would use different data. However, the treatment of such additional costs would depend on the facts and circumstances.

Finance costs

BC196 The Board was asked to provide guidance to not-for-profit public sector entities on whether they should include finance costs, including borrowing costs, in the fair value of an asset that is not held primarily for its ability to generate net cash inflows and is measured at current replacement cost under the cost approach if it necessarily takes a substantial period of time to get ready for its intended use (ie whether the current replacement cost of such an asset should include finance costs that would be incurred during a hypothetical construction). In particular, if a private sector entity constructs an asset on behalf of the not-for-profit public sector entity, and if finance costs were to be included in the asset's current replacement cost, some stakeholders asked for guidance on whether the private sector entity's, or public sector entity's, asset-specific borrowing rate should be used in estimating the finance costs.

BC197 The Board observed that the treatment of borrowing costs and other finance costs when measuring the current replacement cost of an asset is not specific to not-for-profit entities in the public or private sector. It concluded that, in light of AASB 13 not specifying the treatment of those costs for fair value measurements by for-profit entities, it would be inappropriate to mandate a particular treatment for not-for-profit entities applying AASB 13.

BC198 The International Valuation Standards Committee (IVSC) has indicated that consideration should be given to including borrowing costs and equity costs in the fair value of property, plant and equipment. IVS 105 states:

> The cost elements *may* differ depending on the type of the asset and *should* include the direct and indirect costs that would be required to replace/recreate the asset as of the valuation date. Some common items to consider include: (a) direct costs … (b) indirect costs: … **7. finance costs (eg, interest on debt financing)**, and 8. profit margin/entrepreneurial profit to the creator of the asset (eg, return to investors). (paragraph 70.11, emphasis added)

BC199 The Board noted that some stakeholders argue that a not-for-profit public sector entity should exclude borrowing costs from the current replacement cost of an asset if that entity elects, under paragraph Aus8.1 of AASB 123 *Borrowing Costs*, not to capitalise borrowing costs into the cost of qualifying assets. Some of those stakeholders argued that including borrowing costs in an asset's current replacement cost after writing them off on initial recognition of a qualifying asset would give rise to a revaluation gain that reflects inconsistent treatment of borrowing costs at different measurement dates – which they argue would not faithfully represent a change in the asset's value. The Board notes that this is a similar concern to that noted in paragraph BC181(b) regarding restoration costs included in the current replacement cost of an asset without having been incurred during the asset's initial construction, giving rise to what some stakeholders regard as an anomalous gain.

BC200 The Board considered that the accounting policy choice regarding capitalisation of borrowing costs at the asset's initial recognition under AASB 123 is irrelevant to how those costs should be treated in subsequent measurements of an asset that necessarily takes a substantial period of time to get ready for its intended use. This is because the price that market participant buyers would pay for an asset is unaffected by accounting policies adopted in respect of that asset. The recognition of initial costs and subsequent measurement are fundamentally different processes. Therefore, there should be no presumption that the treatment of borrowing costs should be consistent for both. The Board observed that paragraph B4 of AASB 13 identifies a range of circumstances in which an asset's fair value at initial recognition can differ from its transaction price, indicating that items of comprehensive income can arise from differences between the transaction price reflected in initial measurement and fair value.

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Which entity's borrowing rate should be used?

BC201 The Board was also asked to provide guidance to not-for-profit public sector entities about which entity's borrowing rate should be used to measure those borrowing costs, if borrowing costs were to be included in the asset's current replacement cost. Where the cost approach is used, if borrowing costs or other finance costs are included in the asset's fair value measurement, under the guidance in paragraphs F5 and F6:

(a) if all relevant information about market participant assumptions needed to estimate the fair value of the asset is reasonably available, including information about finance costs assumptions, the entity would use those assumptions in measuring the fair value of the asset; or

(b) if some relevant information about market participant assumptions needed to estimate the fair value of the asset is not reasonably available, the entity's own assumptions would be used as a starting point to determine the amount of finance costs to include in the asset's current replacement cost. The entity would adjust those assumptions for any reasonably available information about any different data used by other market participants relating to borrowing and other finance costs.

BC202 However, in respect of the situation described in paragraph BC201(b), the Board observed that, in most cases in which the asset subject to measurement has specialised features, information about other market participants' finance costs (including borrowing costs) specific to constructing the subject asset is unlikely to be reasonably available because applicable finance costs would depend on the financial circumstances of the constructor of the asset. When information about other market participants' finance costs is not reasonably available, the holder of the asset would use its own assumptions in estimating the amount of any finance costs to include in the subject asset's current replacement cost (if the entity determines that finance costs should be included in that asset's current replacement cost).

BC203 One respondent to ED 320 requested the Board to clarify the factors to consider regarding whether finance costs should be included in current replacement cost measurements of fair value (but without mandating either the inclusion or exclusion of funding costs in every circumstance). Consistent with paragraph BC197, the Board decided not to provide implementation guidance on those factors; since the IASB did not specify the treatment of finance costs for fair value measurements by for-profit entities, it would be inappropriate to mandate particular factors for not-for-profit entities to consider in applying AASB 13.

Other types of costs

BC204 During the outreach connected with the Fatal-Flaw Review draft, a stakeholder suggested the Board consider setting out all types of costs that would need to be considered in measuring the current replacement cost of an asset, for example the additional costs of compulsory acquisition of properties acquired to build a road. Furthermore, they suggested the Board includes an example illustrating a common circumstance in which the value for land and improvements is estimated jointly, with the value for the improvements being a residual after deducting the value of the land. The Board noted that the illustrative examples are meant to illustrate how to apply principles, not necessarily to reflect a particular or typical set of circumstances, and considers that illustrating how values are apportioned between land and improvements:

(a) would be a matter for detailed valuation assessments; and

(b) might imply restrictions on how valuers apply the market, income or cost approach.

Therefore, the Board decided not to add such an example.

Obsolescence and depreciation expense

BC205 The Board has been requested to provide guidance on:

(a) economic obsolescence;

(b) curable and incurable physical obsolescence;

(c) adjusting for additional functionality in the modern equivalent reference asset;

(d) asset depreciation; and

(e) whether another description than 'accumulated depreciation' is permitted for disclosing the amount of accumulated obsolescence in financial statements.

BC206 Two respondents to ED 320 reiterated their requests for guidance on issues (b) and (d) and on the appropriate disaggregation of parts of an asset to ensure the correct calculation of depreciation expense.

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BC207 Other than in respect of economic obsolescence (see paragraphs BC209–BC217), the Board decided that further guidance is not warranted regarding (b)–(e) above because:

(a) those issues are not specific to not-for-profit entities; 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.

BC208 In addition, the Board noted that existing AASB pronouncements include guidance addressing some issues listed in (d) and (e). These items of guidance are noted in paragraphs BC222–BC225.

Economic obsolescence (paragraphs F16–F19)

BC209 Paragraph B9 of AASB 13 states that obsolescence incorporated in an asset's current replacement cost includes 'external (economic) obsolescence'. Paragraph IE12(b) of IFRS 13 gives an example of economic obsolescence of a machine held for use, namely, "conditions external to the condition of the machine such as a decline in the market demand for similar machines".

BC210 An equivalent notion of economic obsolescence of an asset or a facility held by a not-for-profit public sector entity is obsolescence arising from a decline in demand for the services provided by the asset or facility, such as a school. The Board was asked to provide guidance on the circumstances in which a not-for-profit public sector entity should identify economic obsolescence of assets measured at fair value using the cost approach, in light of uncertainty and diverse interpretations. In particular, the Board was asked to clarify whether an entity should identify economic obsolescence of a facility that has suffered a reduction in demand for its services before a formal decision has been made to reduce the facility's physical capacity, including a plan for when that decision will be implemented.

BC211 Some stakeholders argued that an entity should not identify economic obsolescence of a facility before a formal decision has been made to reduce the facility's physical capacity because, until then, it is highly unlikely to be clear whether – and to what extent – economic obsolescence exists. The Board noted that the primary consideration in assessing when to identify economic obsolescence is whether market participants would deduct an amount for economic obsolescence from the asset's replacement cost when pricing the asset. This would depend on the entity's circumstances, and not on whether a formal decision has been made to reduce the asset's physical capacity.

BC212 In some instances, it might be clear that market participants would deduct an amount for economic obsolescence when pricing an asset, even if a formal decision has not been made. Deferring inclusion of economic obsolescence in the measurement of the asset's current replacement cost until a formal decision is made would not result in a faithful representation of the adjustment for obsolescence required by paragraph B9 of AASB 13. In addition, such deferral would not result in the best estimate of the price that market participant buyers would pay for the asset, and therefore would be inconsistent with the requirement in paragraph 22 of AASB 13 to measure an asset's fair value using the assumptions that market participants would use when pricing the asset.

BC213 The Board observed that its conclusion on this issue is consistent with the guidance on the measurement of replacement cost in the IPSASB's Conceptual Framework (paragraph 7.41 of which states that an asset's replacement cost reflects reductions in required service capacity, without mentioning a need to formally decide to reduce the asset's capacity).

BC214 The Board noted that part of the debate about the circumstances in which to identify economic obsolescence stemmed from perceptions that AASB 13 does not have regard to the temporary or cyclical nature of shortfalls in demand for services rendered by an asset when determining whether economic obsolescence exists. Therefore, the Board decided to clarify that surplus capacity of an asset that is necessary for stand-by or safety purposes should not be identified as economic obsolescence.

BC215 Increases in demand that eliminate an apparent, but illusory, overcapacity need not be long-term in nature. For example, a school in a mining town might presently appear to have overcapacity but require a higher service capacity than indicated by present enrolments, because its enrolments are cyclical due to peaks and troughs in mining activity. Such apparent overcapacity is similar to standby assets held by entities to cope with peaks in demand: such standby assets are not affected by economic obsolescence simply because they are presently inactive. The Board observed that this is consistent with the guidance in:

(a) the IPSASB Conceptual Framework, paragraph 7.41 of which states that the appropriate service potential included in measuring an asset's replacement cost "is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies"; and

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(b) the New Zealand Accounting Standard for Public Benefit Entities entitled PBE IPSAS 17. Paragraph AG21 of the Application Guidance included in PBE IPSAS 17[2] states that: "No obsolescence adjustment is made in respect of surplus capacity that, while rarely or never used, is necessary for stand-by or safety purposes."

BC216 The Board was asked to provide guidance on whether, for assets measured at current replacement cost and affected by economic obsolescence (eg excess capacity), an entity is required to perform two valuations (one based on the existing capacity, and another based on the estimated required capacity) in order to estimate the gross replacement cost and related accumulated obsolescence of the asset. The Board concluded that only one valuation, based on the required capacity (eg based on a school for 100 students in the example in paragraph F18 in the implementation guidance) would be required at the measurement date. However, the Board also noted that a linear relationship should not be assumed between the extent of economic obsolescence and a reduction in demand for a facility's services. Some assets composing a facility (such as a school) might need to be replaced in full to replace the facility's service capacity. Therefore, simply adjusting the asset's value for obsolescence by the percentage reduction in demand for the facility's services would result in a value that is less than the asset's fair value. In the example presented of a school, the current replacement cost of the school would not reduce by a linear amount per student attending, due to the need to maintain certain components of the school, even as student numbers decline.

BC217 In response to requests for clarification of the proposed guidance in ED 320 or additional examples, the Board included:

(a) in the implementation guidance, an example of an asset with 'surplus capacity' necessary to cater for periods of peak demand, and clarification (in the context of the example of a school with a strong indicator of economic obsolescence) that a linear relationship should not be assumed between the extent of any economic obsolescence and a reduction in demand for a facility's services; and

(b) an illustrative example (Example 5) illustrating that operating an asset for shorter periods than physically is possible, due to the operating environment of the not-for-profit public sector entity, does not of itself indicate economic obsolescence has arisen.

Physical and functional obsolescence

BC218 Some stakeholders requested the Board to consider adding guidance in Australian Accounting Standards to clarify how the curable and incurable parts of an asset's physical obsolescence (as described in IVS 105) should be considered when applying the cost approach. IVS 105 paragraph 80.5 states:

> Physical obsolescence can be measured in two different ways:
>
> (a) curable physical obsolescence, ie, the cost to fix/cure the obsolescence, or
>
> (b) incurable physical obsolescence which considers the asset's age, expected total and remaining life where the adjustment for physical obsolescence is equivalent to the proportion of the expected total life consumed. Total expected life may be expressed in any reasonable way, including expected life in years, mileage, units produced, etc.

BC219 In relation to consideration of the replacement cost of a modern equivalent reference asset to estimate the fair value of the subject asset under the cost approach, a stakeholder commented that AASB 13 deals inadequately with the modern equivalent asset having more features and therefore a higher replacement cost than the subject asset, and requested the Board provides guidance on how to measure the adjustment for the difference in cost between the service levels provided by such a reference asset and the subject asset (which generally is a less-modern asset).

BC220 In respect of the requests noted in paragraphs BC218 and BC219, the Board observed that:

(a) paragraphs B8–B9 of AASB 13 do not distinguish curable and incurable physical obsolescence; and

(b) the IASB did not include guidance on how to measure obsolescence when the cost approach is applied. Implicit in IFRS 13 is a view that determining adjustments to the prices of modern equivalent reference assets is an application issue beyond the scope of IFRS. In the IASB's Report on its Post-implementation Review of IFRS 13 (December 2018), the IASB noted that many respondents asked it to develop additional guidance on the application of judgement regarding particular circumstances, and it decided not to develop additional guidance because, amongst other reasons:

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2 That Application Guidance was created by the New Zealand Accounting Standards Board and is additional to the text of IPSAS 17.

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(i) "the requirements are principle-based, and there will always be a need for exercise of judgement in making these assessments"; and

(ii) "the challenges raised are detailed valuation assessments and an accounting standard-setter may not be best placed to provide guidance in this area" (page 16).

BC221 The Board considered that the issues regarding the distinction between curable and incurable physical obsolescence and the measurement of functional obsolescence are not justifiable circumstances under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require amendments or guidance because they are not specific to not-for-profit or public sector entities. The Board concluded that the issues relate to detailed valuation assessments and enforcing consistent estimation of the pattern of obsolescence over time in the particular circumstances of each valuation is outside the scope of Australian Accounting Standards.

Distinguishing obsolescence from depreciation

BC222 Some stakeholders asked the Board to clarify in Australian Accounting Standards that obsolescence for fair value measurement is different from depreciation. Since paragraph B9 of AASB 13 specifies that obsolescence for fair value measurement under the cost approach is different from depreciation under AASB 116, the Board decided that additional guidance is not warranted. Paragraph B9 of AASB 13 states that: "Obsolescence … is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives)."

BC223 The Board observed that aspects in addition to the depreciation of an asset need to be considered in measuring the fair value of an asset. Paragraph 11 of AASB 13 specifies that fair value measurements take into account characteristics of an asset that market participants would take into account, including, for example, the condition and location of the asset, and any restrictions on the sale or use of the asset.

Method of depreciation

BC224 Regarding comments by some stakeholders that many entities are applying the straight-line depreciation method by default, the Board considers that AASB 116 addresses this issue adequately. Paragraph 60 of AASB 116 states that: "The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."

Description used in disclosures of accumulated obsolescence

BC225 In relation to the requirement in paragraph 73(d) of AASB 116 to disclose accumulated depreciation for each class of property, plant and equipment, some stakeholders asked whether another description than 'accumulated depreciation' is permitted for disclosing the amount of accumulated obsolescence in financial statements. In accordance with the principle in paragraph 57(b) of AASB 101 that the use of other terms, line items or subtotals in financial statements is permitted where such presentation is relevant to the understanding of the entity's financial position or financial performance, the Board considered that using a term other than 'accumulated depreciation' to describe accumulated obsolescence would not be a breach of AASB 116.

Approaches to estimating the fair value of specific public sector assets

BC226 The Board was asked to provide guidance:

(a) on which types of public sector entity assets should be valued under the market, income or cost approach in AASB 13, respectively; and

(b) if the market approach is applied to measure the fair value of assets subject to public-sector-specific restrictions, on the quantum of the discounts deducted from the price of comparable assets that are not subject to those restrictions.

BC227 In relation to the request noted in paragraph BC226(a), the asset types on which stakeholders requested guidance include:

(a) freehold land for which there is an active and liquid market;

(b) land not held in freehold title;

(c) residential or commercial properties located on freehold title;

(d) motor vehicles and other plant for which a primary market exists;

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(e) buildings and other man-made structures other than those located on freehold title, where the buildings are of a nature and type similar to those traded in an active and liquid market; and

(f) infrastructure and other man-made assets other than those used primarily to generate profits (including roads, water, sewerage, recreational and park infrastructure assets).

BC228 The Board observed that for many of these types of assets, there does not appear to be a not-for-profit-specific aspect to the issue; therefore, issuing guidance for not-for-profit entities in relation to their application of AASB 13 could result in the guidance being applied by for-profit entities, potentially leading to their inadvertent non-conformity with IFRS Standards.

BC229 Paragraph 61 of AASB 13 requires an entity to use valuation techniques that:

(a) are appropriate in the circumstances and for which sufficient data are available to measure fair value; and

(b) maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

BC230 A majority of stakeholders who provided input to the FVM project commented that the ability to apply judgement in the circumstances in choosing among the market approach, income approach and cost approach (or a combination of those approaches) generally works well for measuring the fair value of an asset. The Board considered this comment and formed the view that Australian Accounting Standards should not limit the application of the market approach, income approach or cost approach beyond any limits in the requirements of paragraph 61 of AASB 13.

BC231 Issuing the guidance requested by some stakeholders (ie specifying the approach to apply to different types of asset) would appear to conflict with the requirements of paragraph 61 of AASB 13 because it might constrain entities from using the best evidence of fair value in the circumstances. In addition, paragraphs 62 and 63 of AASB 13 indicate that using a combination of the market, income and cost approaches might be appropriate for various assets. Issuing guidance favouring particular approaches for particular types of assets might be incompatible with that 'combination of approaches' guidance in AASB 13.

BC232 Accordingly, the modifications to AASB 13 set out in this Standard (eg the modification of the guidance on 'financially feasible use' in paragraph Aus28.1) do not indicate that the income approach cannot be applied when measuring 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. The entity needs to use judgement in determining which valuation technique (or combination of techniques) to apply, considering all facts and circumstances and the availability of observable inputs relevant to the subject asset.

BC233 In relation to the request for guidance on the quantum of discounts deducted for the effects of restrictions when measuring the fair value of restricted assets using the market approach (see paragraph BC226(b)), the Board noted that, for land held by not-for-profit public sector entities, the market approach is primarily applied. The Board rejected the notion of developing guidance on the quantum of discounts in relation to land for the reasons set out in paragraphs BC253 and BC254.

BC234 Further, the Board observed that most public sector entities do not determine their own accounting policies for applying the requirements of Australian Accounting Standards, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury or Finance Department (or other authority) or the Office of Local Government in each jurisdiction. In relation to the Board's conclusion not to develop guidance beyond the scope of that in this Standard, 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. In effect, where AASB 13 requires the exercise of judgement regarding the appropriate valuation approach, the Treasury or Finance Department (or other authority) and/or the Office of Local Government may apply judgement on behalf of entities in its jurisdiction.

Fair value measurement of land and improvements on land subject to public-sector-specific legal restrictions

Original request from stakeholders in 2017

BC235 All land is subject to zoning restrictions, and some land may have an easement restriction. Stakeholders have informed the Board that many not-for-profit public sector entities are subject to public-sector-specific legal restrictions beyond the zoning and easement restrictions (such as legislation specific to public sector entities or directions from Ministers) prohibiting the entity from using the land and improvements on land for a purpose other than its current use. For example, a not-for-profit public sector entity might be subject to

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a legal restriction prohibiting it from using a hospital and the hospital land for a purpose other than as a hospital.

BC236 This section of the Basis for Conclusions (paragraphs BC237–BC259) discusses public-sector-specific legal restrictions that are expected to be transferred to other not-for-profit public sector market participants in a hypothetical sale transaction. Legal restrictions that would not transfer to other market participants in a hypothetical sale transaction are not considered in fair value measurement of an asset.

BC237 The Board noted that in many cases, the current zoning of the land would reflect the land's public-sector-specific legal restrictions, such as having a community zoning that restricts a parcel of land to be used for community purposes. However, there might be situations in which land is zoned for a commercial purpose, but the not-for-profit public sector entity holding the land is subject to legislation preventing that entity from using any of its non-financial assets for a commercial purpose.

BC238 Panel members and other stakeholders who responded to ITC 34 originally asked the Board to provide guidance on:

(a) how public-sector-specific legal restrictions that would be expected to transfer to other public-sector market participants should be treated when measuring the fair value of land and improvements on land that are not held primarily for their ability to generate net cash inflows; and

(b) which measurement techniques should be used in measuring the fair value of such land.

BC239 Stakeholders informed the Board that the fair value of some land subject to public-sector-specific legal restrictions and not held primarily for its ability to generate net cash inflows 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. This question was asked in the context of paragraph Aus49.1 of the *Framework for the Preparation and Presentation of Financial Statements* (applicable to not-for-profit entities), which states that 'future economic benefits' or 'service potential' can be described as 'the scarce capacity to provide benefits to the entities that use them'.

BC240 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 is undertaking a project to adapt its *Conceptual Framework for Financial Reporting* (2021) for application by not-for-profit entities, including those in the public sector. The Board plans to consider the description of service potential in the context of an asset of a not-for-profit entity as part of that project. At this stage it is unclear whether that Board consideration would have implications for the measurement of restricted land.

Feedback from public sector stakeholders during outreach

BC241 After conducting wide-ranging outreach, including outreach on ITC 45, the Board noted feedback that there is not significant inconsistency in how the fair value of restricted land and improvements on restricted land not held primarily for their ability to generate net cash inflows are being measured. In this regard:

(a) most stakeholders commented that the market approach is used to measure the fair value of land, including land subject to public-sector-specific legal restrictions; whereas improvements on such restricted land are generally considered specialised assets, for which the cost approach is generally applied in measuring their fair value; but

(b) a minority of stakeholders commented that, when a parcel of land of a not-for-profit public sector entity not held primarily for its ability to generate net cash inflows is subject to public-sector-specific legal restrictions, but an equivalent parcel of land with 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, the fair value of such land should be measured using the cost approach.

BC242 The views of these stakeholder groups are elaborated on in paragraphs BC243–BC253.

The minority view regarding land subject to public-sector-specific legal restrictions

BC243 The minority of stakeholders mentioned in paragraph BC241(b) 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

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reduce the fair value of such restricted land to an amount less than the price of equivalent land without those restrictions. This is because, if an equivalent restricted parcel of land is not obtainable in the marketplace, the entity would need to purchase an equivalent parcel of land without those restrictions to continue delivering services, and the existence of such a restriction does not affect the price of this purchase.

BC244 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.

BC245 Further, those stakeholders considered that, because the land subject to public-sector-specific legal restrictions is not held primarily for its ability to generate net cash inflows, it would generally be inappropriate to apply the income approach as an alternative to the market approach and, consequently, the cost approach should be used to measure the fair value of such restricted land.

The majority view regarding land subject to public-sector-specific legal restrictions

BC246 The majority of stakeholders mentioned in paragraph BC241(a) expressed the view that land, including land subject to public-sector-specific legal restrictions, should generally be measured using the market approach. They disagree with the view expressed by the minority of stakeholders noted in BC243 – that the cost approach should be applied in measuring such restricted land, and the fair value of such restricted land would not be lower than the price of equivalent land without such restrictions because of the effect of public-sector-specific legal restrictions, if an equivalent restricted parcel of land is not obtainable in the marketplace at the measurement date for a price supported by observable market evidence. Under the market approach, the fair value of a parcel of land should reflect any restrictions on that land, including any public-sector-specific legal restrictions, that would transfer to market participants in a hypothetical sale transaction.

BC247 This majority of stakeholders commented that although an 'equivalent' parcel of land with the same public-sector-specific legal restrictions might not be obtainable in the marketplace at the measurement date for a price supported by observable market evidence (because public-sector-specific legal restrictions often prevent an entity from selling the land), there are market transactions for other parcels of land that are suitable reference assets. Therefore, those stakeholders consider there are more relevant observable inputs for applying the market approach, rather than the cost approach, in measuring the fair value of land subject to such restrictions.

BC248 Some of the stakeholders referred to in paragraph BC247 also commented that any improvements (eg a hospital building) on a parcel of land reduce the land's service potential. They consider that improvements on land would reduce the options the not-for-profit public sector entity holder of the land has to use the land for another purpose, unless the improvements are demolished.

The Board's decision not to provide authoritative implementation guidance

BC249 Notwithstanding the interpretation of paragraphs BC78 and BC79 of IFRS 13 in paragraphs BC244 and BC245 by a minority of stakeholders, in which they concluded that the cost approach would often be appropriate in measuring the fair value of land subject to public-sector-specific legal restrictions, the Board noted that paragraph 61 of AASB 13 requires an entity to select measurement techniques:

(a) that are appropriate in the circumstances;

(b) for which sufficient data are available to measure fair value; and

(c) that maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

BC250 Therefore, 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 inconsistency 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.

BC251 Despite the debate regarding fair value measurement of land subject to public-sector-specific legal restrictions, feedback from most stakeholders in targeted outreach and most feedback on ITC 45 indicated

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that, in practice, the fair value of each type or class of assets affected by this issue is being measured using a largely consistent approach – that is:

(a) for land subject to public-sector-specific legal restrictions, the market approach is used (although, as noted in paragraph BC253 below, at a more detailed level, different methods are being used to calculate the adjustments to reflect restrictions); and

(b) for improvements on such restricted land, the cost approach is generally used, and an adjustment is not deducted to reflect the effect of public-sector-specific legal restrictions because the existence of a public-sector-specific legal restriction does not affect the price that the entity would need to incur to replace the asset at the measurement date.

BC252 In addition, the Board noted that paragraph 11 of AASB 13 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 on the sale or use of the asset. This would include consideration of any public-sector-specific legal restriction that would be transferred to a market participant.

BC253 Some stakeholders commented that there is inconsistency in practice regarding the amounts (eg percentages) of adjustments being deducted from the value of land to reflect public-sector-specific legal restrictions, and asked the Board to provide guidance to reduce that inconsistency. Further, some stakeholders informed the Board that different valuers use different methods in calculating the adjustments, for example:

(a) using the price of nearby land not subject to the same public-sector-specific legal restriction and explicitly deducting an adjustment for the effect of the restriction (explicit adjustment); or

(b) using the price of land with a much lower intensity of use – and, consequently, a much lower value – than that of nearby land without a public-sector-specific legal restriction and not explicitly deducting an adjustment for the effect of the restriction because it is implicitly taken into account by using cheaper land in a lower-intensity-of-use location as a reference asset (implicit adjustment).

BC254 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.

BC255 As noted in paragraph BC234, in deciding not to develop guidance specific to fair value measurement of land subject to public-sector-specific legal restrictions, the Board observed that 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.

Stakeholder feedback on ED 320

BC256 A majority of respondents who commented on this topic agreed with the Board's decision not to mandate the measurement technique to apply for measuring the fair value of specific assets, including land subject to public-sector-specific legal restrictions. However, a few respondents requested the Board to mandate the use of the cost approach in measuring the fair value, or the use of an entity-specific entry price to measure the current value, of all non-financial assets of not-for-profit public sector entities not primarily held for their ability to generate net cash inflows. The Board observed that the feedback received on ED 320 did not identify any supporting or opposing arguments that had not yet been considered by the Board in deciding that fair value should remain the sole current value measurement for non-financial assets and not to mandate the measurement technique to apply for measuring the fair value of specific assets, including restricted land.

BC257 In addition, a few other respondents asked the Board to elevate paragraph IE29 of the IASB's Illustrative Examples accompanying IFRS 13 (quoted in paragraph BC103) to authoritative guidance. That IASB illustrative example included a comment indicating that restrictions would be taken into account only if they transfer to the market participant buyer, and those respondents envisage that elevating the specific comment to authoritative guidance would effectively preclude the deduction of discounts for restricted land.

BC258 The Board observed that the IASB decided to include that example 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. Accordingly, adding such an example in the Board's

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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 interpret the example as a rule of thumb. This is because:

(a) the IASB's conclusion in the above-mentioned paragraph IE29 of its Illustrative Examples that "the donor restriction on the use of the 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) that example did not include consideration of the zoning of the land and the likelihood that the zoning would change as stated in paragraph 140.5 of International Valuation Standard IVS 104 *Bases of Value*.

BC259 The Board considered that financial statement preparers, auditors and valuers need to apply judgement, based on the circumstances of each asset, in determining whether a restriction imposed on an asset would transfer to market participants. Therefore, the Board decided not to add that IASB example to AASB 13.

Other measurement issues

BC260 Some stakeholders asked the Board to provide guidance regarding the following:

(a) treatment of changes in an asset's estimated remaining service potential;

(b) treatment of damage of an asset;

(c) allocating the fair value of groups of assets measured under the income approach to component assets;

(d) treatment of deferred maintenance expenditure; and

(e) unit of account for an infrastructure asset.

BC261 The Board noted that none of the issues in paragraph BC260 represents a justifiable circumstance under the *AASB Not-for-Profit Entity Standard-Setting Framework* that would require not-for-profit-specific modifications or guidance. This is because:

(a) those issues are not specific to not-for-profit 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.

BC262 The Board considered that some of those issues relate to detailed valuation assessments, and specific guidance on them should not be included in Australian Accounting Standards. The Board also considered that the treatment of many of the issues would depend on facts and circumstances, and the role of principles-based Standards does not include providing detailed guidance about the various outcomes that can arise.

Effective date and application

Prospective application

BC263 In accordance with paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards*, the Board decided that the modifications to AASB 13 made by this Standard should be applied prospectively for annual periods beginning on or after 1 January 2024.

BC264 The Board noted that the existing Standard was initially required to be applied prospectively, consistent with IFRS 13 *Fair Value Measurement*. As stated in paragraph BC229 of the Basis for Conclusions on IFRS 13, "… the IASB concluded that a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement) ... Therefore, the IASB concluded that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate)." For the same reason, the Board decided that the modifications to AASB 13 should be applied prospectively.

BC265 The Board considered that the modifications to AASB 13 mainly clarify that Standard, rather than changing its requirements. In applying the modifications, an entity's changing practice in how it measures the fair

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value of non-financial assets not held primarily for their ability to generate net cash inflows does not indicate an error had been made previously in applying the existing requirements of AASB 13.

BC266 In accordance with paragraphs 37–40 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, prospective application of the authoritative implementation guidance would require an entity to:

(a) recognise any change in asset values by adjusting the carrying amount of the affected assets and equity items in the period of the change; and

(b) disclose the nature and amount of the change in asset values that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

Voluntary restatement of comparative information

BC267 In ED 320, the Board invited comments on whether an option should be provided for not-for-profit public sector entities to elect to restate comparative information to the extent practicable, instead of applying the amendments to AASB 13 prospectively. A majority of those responding to that question disagreed with the provision of such an option, because:

(a) restating comparative information about fair values for prior periods would be likely to involve the use of hindsight;

(b) a change in fair value should be treated as a change in an accounting estimate (ie prospectively); and

(c) it might be confusing for users to understand the fair values presented in financial statements if prior period balances were restated, which would have a flow-on effect to the depreciation amounts previously recognised.

BC268 Having regard to the comments received, the Board decided not to provide an option to restate comparative information upon initial application of the Amending Standard.

Not-for-profit private sector entity consideration

BC269 When developing ED 320, the Board observed that limiting the AASB 13 modifications to not-for-profit entities in the public sector might be perceived as being inconsistent with its transaction neutrality policy. Therefore, ED 320 included a question asking respondents whether the proposed modifications to AASB 13 should be applicable also to entities in the not-for-profit private sector. Mixed feedback was received on that ED question.

BC270 The Board decided to limit the scope of this Amending Standard to not-for-profit public sector entities because the Board did not receive any requests for guidance from stakeholders in the not-for-profit private sector during the project. To the date of issuing this Standard, the Board has not been informed that:

(a) a significant number of not-for-profit private sector entities measure their non-financial assets at fair value;

(b) not-for-profit private sector entities are encountering significant issues with applying AASB 13 in measuring non-financial assets; or

(c) some principles of AASB 13 have been applied inconsistently in this sector in measuring non-financial assets (unlike in the public sector).

BC271 The Board noted that limiting the scope of modifications to not-for-profit public sector entities may not necessarily breach its transaction neutrality policy because many assets held by not-for-profit public sector entities are largely unique to the public sector. That is, for many assets, it is unlikely that private sector entities would hold similar assets to those held in the public sector.

BC272 Even if it were considered that limiting the modifications to not-for-profit public sector entities would be inconsistent with the transaction neutrality policy, the Board considered that this would be justified. This is because, unlike public sector entities, private sector entities have a choice to subsequently measure their non-financial assets using the cost model rather than the revaluation model (in AASB 116 or AASB 138 *Intangible Assets*). This results in non-financial asset values measured using different models among private sector entities' financial statements, thus being less comparable than the asset values reported by public sector entities. Accordingly, applying this Amending Standard, which is limited to measuring non-financial assets using the revaluation model, would not fully achieve comparability among not-for-profit private sector entities in measuring their non-financial assets.

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BC273 In accordance with the *AASB Not-for-Profit Entity Standard-Setting Framework*, for the reasons noted in paragraphs BC270–BC272, the Board determined that a case has not been made for it to undertake standard-setting work to investigate whether there is a need to modify AASB 13 for application by not-for-profit private sector entities.

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