

Keeping the public sector informed on financial reporting developments
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Fair value measurement—proposed guidance for not-for-profit public sector entities

Background

In the public sector, most non-financial physical assets (such as land, buildings and infrastructure assets) are carried at fair value. However, many of the for-profit based concepts in AASB 13 *Fair Value Measurement* (AASB 13) have been problematic to apply in the public sector context because of the unique nature of many public sector assets. For example, there have been challenges in identifying appropriate market participants.

As a result, there is diverse practice for fair valuing non-financial physical assets in the public sector, particularly those not held primarily to generate net cash inflows.

Having heard stakeholder feedback, the AASB has recently released its proposed implementation guidance (along with some illustrative examples) in the form of Exposure Draft ED 320 *Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* (ED 320).

In a nutshell

- Not-for-profit public sector entities have faced significant challenges applying AASB 13 to non-financial physical assets because of their unique nature, resulting in divergent practice.
- The Australian Accounting Standards Board (AASB) has recently released proposals to provide authoritative implementation guidance to help the sector and promote consistent application of the requirements. Comments on the proposals are due by 30 June 2022.
- Proposed guidance is expected to apply prospectively for annual periods beginning on or after 1 January 2024.
- The proposals have the potential to have a widespread impact on the sector.

Key proposals

ED 320 proposes guidance for fair value measurement of non-financial physical assets not held primarily for their ability to generate net cash inflows. The following table outlines key areas of ED 320 and the associated guidance.

Area	Guidance
Market participant assumptions	<ul style="list-style-type: none"> • If the market selling price of an identical asset is not directly observable, the entity still maximises the use of observable inputs in measuring the fair value of the asset. • If the entity needs to develop unobservable inputs, the entity uses its own assumptions as a starting point and adjusts those assumptions if reasonably available information indicates that other market participants would use different data.
Highest and best use	<ul style="list-style-type: none"> • The circumstance in which market or other factors indicate that an alternative use to the entity's current use of the asset has become the asset's highest and best use is when the appropriate level of the entity's management is committed at the measurement date to a plan to sell the asset or to use the asset for an alternative purpose. • An entity only needs to assess whether a use of the asset is physically possible, legally permissible and financially feasible when the presumption that the current use is its highest and best use is rebutted. • A use is considered financially feasible if market participants (including not-for-profit public sector entities) would be willing to invest in the asset's service capacity.
Application of the cost approach	<ul style="list-style-type: none"> • It is assumed that the asset will be replaced in its existing location, even if it would be feasible to replace the asset in a cheaper location. • All necessary costs intrinsically linked to acquiring or constructing the asset at the measurement date are included in the asset's current replacement cost because it is assumed that the subject asset presently does not exist and all components of the asset need to be replaced. • Identification of economic obsolescence is not limited to circumstances in which a formal decision has been made to reduce the asset's physical capacity. • 'Surplus capacity' of an asset that is necessary for stand-by or safety purposes is not identified as representing economic obsolescence.

Effective date

The ED is open for comment until 30 June 2022.

The proposals in the ED are expected to apply prospectively for annual reporting periods beginning on or after 1 July 2024.

Likely impact on the public sector

Non-financial physical assets are a significant proportion of the balance sheet of many public sector entities. Depending on the non-financial assets held by an entity and its current accounting policy/practice, the ED proposals may have a substantial impact on the value reported on the entity's balance sheet.

Action required

It is paramount that public sector entities:

- get involved in AASB's public consultation process and give feedback while the proposals are still in draft stage
- revisit your current accounting practice in light of the proposals
- liaise with your VAGO audit team contact if you anticipate any potential changes to the current practice
- start preparing for future implementation of the proposals once finalised by the AASB.

Contact information

If you wish to discuss any of the information included in this tech alert, please reach out to your VAGO contact or a member of the financial reporting advisory team at enquiries@audit.vic.gov.au.