NSW Treasury

Guidance on the application of AASB 2022-10 Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities

Friday, 14 March 2025

Introduction

This guidance relates to AASB 2022-10 *Amendments to Australian Accounting Standards – Fair Value Measurement of Non-Financial Assets of Not-for-Profit Public Sector Entities* (AASB 2022-10). AASB 2022-10 amends AASB 13 *Fair Value Measurement* (AASB 13), including adding authoritative implementation guidance and providing related illustrative examples, for 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.

The content of this guidance will be included in an updated version of TPP21-09 *Valuation of Physical Non-Current Assets at Fair Value* (TPP21-09). Treasury intends to make consequential amendments to ensure that publication is consistent with this guidance.

AASB 2022-10 has been fully compiled into AASB 13. Therefore, paragraph references in this guidance are to AASB 13.

Summary

According to AASB 13, Appendix A, the cost approach reflects the amount required to replace the service capacity of the asset. This should include all costs that would be incurred by a typical market participant seeking to create an asset of comparable utility. While AASB 13 provides principles for asset valuation, it does not specify what types of costs should be included in the calculation of an asset's fair value under the cost approach. When valuing an asset under the cost approach entities are required to include all necessary costs intrinsically linked to acquiring or constructing the asset (i.e. a substitute asset of comparable utility, adjusted for obsolescence) at the measurement date (AASB2022-10.BC154).

This is consistent with AASB 13, para 11 that requires the fair value to take account of the characteristics of an asset, including its condition and location.

For real property, replacement cost must reflect all incidental costs, as appropriate, such as the value of the land, infrastructure, design fees, finance costs and developer profit that would be incurred in creating an equivalent asset (IVS 400 *Real Property Interests*, para 70.5).

AASB 2022-10

AASB 2022-10 applies to annual periods beginning on or after 1 January 2024.

Significant professional judgement is required in estimating the fair value of an asset using the cost approach. In particular, in the public sector, assets are often specialised and there may be limited observable information on the price a market participant would pay to acquire or construct those assets. AASB 2022-10 applies specifically to assets of not-for-profit public sector entities, that are not held primarily for their ability to generate net cash inflows and includes:

- *Amendments* to AASB 13 that clarify when 'highest and best use' is current use and how 'financially feasible' is applied.
- *Guidance* on applying AASB 13, including consideration of certain types of costs.

Summary of AASB 2022-10

Scope of AASB 2022-10

AASB 2022-10 applies specifically to non-financial assets of not-for-profit public sector entities that are <u>not held primarily for their ability to generate net cash inflows</u>. The amendments and guidance address how to estimate fair value using the hypothetical acquisition or construction cost of a replacement asset at the measurement date.

Amendments to AASB 13

For assets of not-for-profit public sector entities, that are not held primarily for their ability to generate net cash inflows, AASB 2022-10 introduces the following Australian specific amendments:

- **Current use is highest and best use**, unless the asset is classified as held for sale in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* or it is highly probably the asset will be used for an alternative purpose to its current use (AASB 13.Aus29.1 and Aus29.2).
- The **'financially feasible' criteria is met** if market participants would invest in the asset's service capacity (AASB 13.Aus28.1).

Summary of guidance in AASB 2022-10

AASB 2022-10 introduces implementation guidance for the public sector in Appendix F to AASB 13. The implementation guidance expands on existing requirements in AASB 13 and how these apply specifically to assets of not-for-profit public sector entities, that are not held primarily for their ability to generate net cash inflows.

Key guidance in Appendix F:

- An entity's management should use its **own assumptions** to the extent other data is not observable (AASB 13.F5).
- **Exhaustive efforts need not be undertaken** to identify market participant information, or whether an entity's own information needs to be adjusted. However, market information that is reasonably available cannot be ignored (AASB 13.F6).
- Assumes a reference asset (*) is acquired or constructed **at the subject asset's existing location** (AASB13.F11(a)).
- Includes certain types of costs (refer below) if they are judged to be **necessarily incurred** in the **hypothetical acquisition or construction** of the reference asset at the measurement date (AASB 13.F12).

(*) 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, i.e. the asset being valued. 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) – AASB 13.F10.

Types of costs that should be considered for inclusion in replacement cost, if necessarily incurred

Guidance added by AASB 2022-10 on application of the cost approach does not impact land valued under the market approach, which is usually the approach adopted by NSW Government agencies.

AASB 2022-10 introduces to AASB 13 additional guidance on the following types of costs:

1. Costs to restore third-party assets (AASB 13, para F12(a))

A third-party asset is an asset held by another party which is not part of the consolidated group to which the entity belongs.

Examples of third-party assets could be pipes underneath the entity's building, third-party telecommunication equipment on the entity's bridges or third-party assets that are adjacent to the entity's asset, such as a footpath.

This relates to circumstances where assets that would need restoration existed at the measurement date and would be disturbed in a hypothetical acquisition or construction of the reference asset.

2. Other disruption costs (AASB 13, para F12(b))

Other disruption costs are costs that would hypothetically be incurred when acquiring or constructing the reference asset at the measurement date.

An example of other disruption costs is costs of redirecting traffic when replacement of the reference asset, such as a drainage pipe, disrupts the operation of a road.

3. Site preparation costs (AASB 13, para F12(c) and F13)

Site preparation costs are relevant when a subject asset is fixed to a parcel of land (eg a building or a road).

Site preparation costs include, but are not limited to:

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

Site preparation costs for the reference parcel of land on which the reference asset would hypothetically be constructed are included in the calculation of the replacement cost of the reference asset, unless those site preparation costs are reflected (explicitly or implicitly) in the fair value measurement of the subject parcel of land.

Detailed consideration of the Implementation Guidance in Appendix F

Appendix F explains how the principles in AASB 13 should be used 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.

Exit Price

For an asset, fair value is the price that would be received to sell that asset in an orderly transaction between market participants at the measurement date (AASB 13.9). This is also known as the 'exit price' (AASB 13.2). The principle of an exit price exists even where that price is not directly observable (AASB 13.24) and is not changed by the amendments in AASB 2020-10.

Use of the Cost Approach

The best evidence of fair value (i.e. exit price) is sometimes an asset's buying price, rather than selling price. Buying price can be an estimate of fair value, 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 (AASB 13.BC153).

Necessarily incurred

To the extent that it is judged that the above costs would need to be **necessarily incurred** as part of the hypothetical acquisition or construction of the reference asset at the measurement date the costs should be included in the calculation of the replacement cost of the reference asset (AASB 13.F12).

AASB 2022-10 requires estimates of replacement cost to be based on a hypothetical acquisition or construction of a reference asset (AASB 13.F9, F10, F12). 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, i.e. the asset being valued.

AASB 13.BC154 states that *"…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 to acquire or construct it in its entirety…"*

Therefore, when performing the valuation, it should be assumed that the subject asset does not exist and it needs to be newly constructed, rather that the asset exists and has to be replaced.

As a consequence, once-only costs should form part of the costs to construct a reference asset, where they would be necessarily incurred in a hypothetical acquisition or construction of the reference asset at measurement date. For example, the current replacement cost of a road should include design work, earthworks and formation costs even when these components do not wear out and therefore do not require replacement in the future.

At the same time, all the other characteristics of the subject asset location are taken into consideration for valuation purposes as of the measurement date, e.g. third party assets that would need restoration in a hypothetical acquisition or construction of the reference asset.

Heritage assets and assets with heritage features

Many assets in the public sector are held entirely for heritage purposes. Other assets contain heritage features. For example, a court building with a heritage facade. A reference asset can be a modern equivalent or a replica asset and judgement is needed in identifying a suitable alternative asset (AASB 13.F10). However, in certain circumstances it is appropriate to include the cost of replicating certain heritage features in necessarily incurred costs.

Use of own assumptions

AASB 13, para F11(b) clarifies that 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, 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 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.

Hypothetical versus actual costs

AASB 13 para F12 specifically clarifies that the costs of a reference asset are **hypothetical** costs rather than actual. This means that even if an entity has never incurred certain costs when constructing the original subject asset, the entity should nevertheless consider whether hypothetical construction of the reference asset at the measurement date would require those costs to be incurred.

Actual costs incurred when constructing a subject asset are not always typical for similar projects and, therefore will not always be assessed as necessarily incurred when estimating costs to construct the reference asset. For example, a school may be built in place of an old factory building. When valuing the school building a market participant would not factor in historical costs of demolishing of the factory if typically, schools are built without incurring these costs. However, if schools are typically built on sites with existing buildings or other infrastructure that require demolition, it may be appropriate to include such demotion costs in the current replacement cost of school buildings (if not already included in the valuation of the subject parcel of land).

Even though actual costs incurred when constructing an asset are not necessarily part of its fair value, these actual costs may be a useful input for forming entity's own assumptions about the costs currently required to acquire or construct the reference asset. For example, information about recent projects to construct schools in regional areas can be used to estimate the replacement cost of schools in these areas.

No need to undertake exhaustive efforts to obtain information

AASB 2022-10 introduces the principle that, an entity **need not undertake exhaustive efforts** to obtain information about the types of costs specifically discussed in Appendix F. However, an entity shall include all such costs for which data is reasonably available (AASB 13, para F14).

This means if there are costs that could potentially be necessarily incurred in a hypothetical acquisition or construction of the reference asset at the measurement date, but the entity does not have reasonably available information about these costs, they do not have to be included in the reference asset's current replacement cost.

For example, if the entity does not have specific information about third-party assets that would need restoration in case of hypothetical acquisition or construction of the reference asset or could not reasonably obtain information, it is likely that hypothetical market participant buyers would also not have this information. Accordingly, the subject asset's current replacement cost should not include these costs as specific items (they can however be part of unmeasurable contingency costs). These judgements should be reviewed, documented and re-assessed periodically by the entity.

Treasury Guidance on the types of costs in Appendix F

General Guidance

In estimating fair value using the estimated replacement cost of a hypothetical reference asset, agencies should apply the following principles from AASB 13. These principles can be used as a hierarchy in assessing whether specific costs should be included in the hypothetical replacement cost of an asset at the measurement date.

1. Fair value is an <u>exit price</u>.
2. <u>Current</u> use should be taken to be highest and best use, unless AASB 13.29.1(a) or (b) apply.
    - Replacement cost relates to a <u>hypothetical</u> acquisition or construction.
3. Assume the reference asset is acquired or constructed at the subject <u>asset's existing location.</u>
4. Replacement cost includes all costs that would <u>necessarily be incurred</u> by <u>any market participant</u> at the measurement date.
5. An entity need <u>not undertake exhaustive</u> efforts to obtain information about the types of costs.

Costs to restore third-party assets

In constructing major infrastructure, it is often necessary to incur costs to restore assets owned by third parties, when those assets are impacted during the construction process. For example, construction of a light rail might require removal and installation of replacement utility assets. The current accounting treatment is for such costs to be included in property, plant and equipment work-in-progress, as long as the relevant assets are controlled by the entity during construction. A grant expense is then recognised, when control of the assets returns to the third party.

Applying the guidance above, such costs would only be included in replacement cost fair value, if a hypothetical market participant would necessarily disturb and restore the same third party assets in a hypothetical construction at the measurement date. In many instances, it is expected that restoration of the third party assets would not be included in replacement cost, because a subsequent construction would not need to disturb those same assets as they have already been removed from the existing location of the subject asset.

However, there may be other third-party assets that have been installed by third parties or by the entity itself at the subject asset location after it was constructed. Restoration of these other assets may need to be factored in replacement costs of the reference asset even though these costs have never been incurred, ie, they are hypothetical.

Actual costs incurred by the entity in the original construction may be useful inputs in developing assumptions for current replacement cost. However, only if those historical costs would necessarily be incurred by a market participant (or hypothetical market participant) currently.

If the entity does not have reasonably available specific information about third-party assets that would need restoration in a hypothetical acquisition or construction of the reference asset, it should be assumed that hypothetical market participant buyers would also not have this information. Accordingly, the subject asset's current replacement cost should not include these costs.

Where exhaustive efforts are required to identify third party asset information e.g. where the entity does not hold this information and would be required to engage with the third parties or undertake extensive inquiries to obtain this information, then the information is not reasonably available. Accordingly, in these circumstances the subject asset's current replacement cost should not include these costs.

Hypothetical costs to restore assets held by other parties that are consolidated in the NSW Total State Sector Accounts, should be excluded from a reference asset's replacement cost. Agencies are expected to assist valuers identify such assets within their third party asset information (only where such information is reasonably available and would not require exhaustive effort to obtain), including sharing information on entities consolidated in the NSW Total State Sector Accounts.

Entities should assess whether third-party asset costs would necessarily be incurred by a market participant. For example, if an entity occupies a few floors in a multiple storey building, it is not expected that a market participant would incorporate costs of reconstructing the entire building in valuing the entity's floors, as such costs would not be considered "necessarily incurred".

AASB states in AASB2022-10.BC 181-183, that the following are not sufficient reasons to exclude these costs from valuations at the current replacement cost:

- the entity does not control the other entity's asset that is being restored, and
- the entity did not incur those costs when the subject asset was initially constructed, or those disrupted assets did not exist when the subject asset was initially constructed.

Other disruption costs

AASB 2022-10 does not include a definition of 'disruption costs'. However, the following costs are included as examples, when constructing a replacement road:

- Costs of redirecting traffic (AASB13.F12(a)).
- Employing safety officers (AASB13.BC179).

Therefore, disruption costs can be interpreted broadly, to include costs related to the disruption of activities of third parties or the entity itself.

However, AASB 2022-10.BC180 makes it clear that disruption costs are only included in the estimated replacement cost of fair value where all the following apply:

- Intrinsically linked to the hypothetical acquisition or construction of the reference asset at the measurement date.
- Would necessarily be incurred by a market participant.
- Reflect the pricing assumptions a market participant would make.

Market participants would only make assumptions using information they could reasonably know. Where a reporting entity would need to undertake exhaustive efforts to obtain information about costs, those costs are assumed to be unknown to the market participant and should not be included in the estimate of the replacement costs of the hypothetical asset at the measurement date.

Some disrupted activities will have associated variable operating costs. Where disruption costs are included in replacement cost, care should be taken to only include the net incremental cost, by deducting any savings associated with the disrupted activity. In some instances agencies will need to obtain information or estimate costs savings that arise in another agency.

When valuing roads, costs such as traffic management costs are intrinsically linked to construction of roads and should be part of road's replacement costs. When valuing other assets, traffic management costs may also need to be incorporated in their value, e.g. when construction of a hospital requires temporary closure of roads in the area.

It is expected that the types of disruption costs included in fair value will be limited. A hypothetical market participant is assumed to be constructing the entire asset at the measurement date. Disruption costs to another party's activities would be included if the only way to construct that reference asset would be to necessarily disrupt third party activities. This would be limited to disruptions of third party activities that are intrinsically and typically associated with that type of construction.

The costs of disrupting activities unrelated to the reference asset, that just happen to be in an adjacent location, would not meet the necessarily incurred criteria.

Site preparation costs

Site preparation costs include costs to prepare land for construction and costs to remove and dispose of unwanted existing structures (demolition costs) (AASB 13.F13). In determining whether site preparation costs should be included in the replacement cost of a hypothetical construction, agencies should consider the following, when applying the principles above.

1. *Exit price*

Exit price is the overriding principle in AASB 13. For assets held primarily for their service potential in the public sector, exit price is highly theoretical. This is because there are often no identifiable market participants and because current replacement cost is a different concept to exit price on a disposal.

The theoretical exit price for assets held primarily for their service potential in the public sector is based on the following assumptions:

- What another, identical government, would pay to acquire the same asset for the same use.
- Using the cost approach to estimate exit price, assumes a market participant would not pay more than that amount to replace the service capacity (AASB 13.BC153).

In applying the principles in this policy to site preparation costs, an overriding consideration, is that if there are no other market participants the estimated fair value should not exceed the theoretical amount another government that has similar functions would pay to replace the service capacity of the existing asset.

2. *Current use is presumed to be highest and best use*

Following from the theoretical exit price, the fair value assumptions should reflect what a current government would pay to replace its existing asset to provide the same service capacity. This assumes the asset's current use is identical to the use by the hypothetical market participant. And that use is the highest and best use.

- Hypothetical construction

AASB 2022-10 acknowledges that the reference replacement asset is a hypothetical construction or acquisition. The hypothetical reference asset is not necessarily assumed to be constructed identically to the original asset. In practice, replicating the original construction methods or asset will often not be possible or desirable. In making judgements about whether site preparation costs should be included in a hypothetical construction, consideration should be given to the range of options available to construct the asset that a market participant would reasonably consider.

3. Existing Location

This principle requires replacement cost to assume the hypothetical asset is constructed at the location of the existing asset, consistent with AASB 13.F11(a).

In some instances, land adjacent to an existing asset's location may provide evidence of whether site preparation costs would form part of the replacement cost of the reference asset. This would be the case where a hypothetical market participant would assess that adjacent location to have substantially the same features, including physical attributes and legal restrictions.

However, care should be applied, because site preparation costs are commonly included in the fair value of land. For example, two pieces of land that are identical (e.g. size, location, zoning, highest and best use etc), but one piece of land has pre-existing structures that need to be removed for the highest and best use. It would be expected that the market value of that land would be discounted for the costs of removing those structures.

It should not be assumed that the reference asset would be necessarily constructed on that adjacent land. For example, just because a school is located in a residential area, it is not appropriate to assume that a market participant would necessarily incur the cost of demolishing enough houses to provide land for a school. Making such an assumption also might not result in an appropriate exit price for the specific asset. In this instance, experience in building new schools generally, might indicate that clearing sites entirely occupied by houses is not typical.

4. Necessarily incurred

For site preparation costs, "necessarily incurred" can be interpreted as costs that would always need to be incurred in construction of a replacement asset at the measurement date at the existing location.

5. Need not undertake exhaustive efforts to obtain information about the types of costs

Where an entity does not have existing information on specific site preparation costs, or information, such as costs for a typical construction project, are not reasonably available the practical expedient in AASB 13.F14 applies. This assumes that a hypothetical market participant would not choose to incur site preparation costs that are not necessarily incurred and well known for any construction of the specific asset, at that location.

Site preparation costs might, therefore be included in replacement cost where, for example, the entity has standard or actual cost information, based on costs that would typically be incurred in constructing that type of asset at the measurement date.

Example – Site Preparation Costs

Road A is owned and controlled by a state department of transport and was constructed 50 years ago in a major metropolitan city. Construction was predominantly on vacant land corridors set aside by the government for roads. Relatively smaller areas of non-residential land were also acquired. Where the road intersections were constructed, it was necessary to purchase a small number of existing residential buildings. Road A passes through mainly built up residential and industrial areas. Since construction of Road A, significantly more residential buildings have been constructed on the land adjacent.

Applying the principles taken from AASB 13, the department of transport assesses:

- That the current use of the road and the land under the road as a public road, is the highest and best use.
- The road in a hypothetical replacement would be constructed on the location of the existing road. This means the fair value should reflect a theoretical exit price for the existing road.
- The original construction of Road A provides useful indicators of the costs a market participant would necessarily incur to construct a hypothetical replacement asset today. Also, agencies need to consider any available information on recently completed similar projects. The government would be unlikely to construct a replacement road today that included compulsory purchase and demolition of a substantial number of residential homes along the entire route of Road A. This is because the cost, including the loss of housing to the community, would exceed the service benefits provided by the road.
- Instead, a hypothetical asset would be constructed on land that is available and economically viable. The department's standard costing reflects the assumption that the land is available and economically viable.
- The purpose of the road is to link existing residential areas. Therefore, while it is not necessary to construct the majority of the road on existing residential land, the construction of any hypothetical replacement road would need to include some demolition and site preparation costs, at the intersections that link the road to residential areas. The basis for estimation of these costs could be actual historical costs for the subject asset (if available) adjusted for price changes or costs of typical recent projects for similar assets.

Conclusion

The estimated replacement cost of a hypothetical replacement road would include demolition costs of structures assumed to be acquired where Road A intersections meet other roads. It would not otherwise include demolition costs of residential homes adjacent to Road A.

- The department holds no specific or standard costing information based on constructing a new road predominantly over existing residential homes. This is consistent with the department's assessment that it is unlikely a government would demolish that many homes to build a road.

- A market participant would not include the costs of demolishing homes along the entire road, because they are not necessarily incurred in constructing the hypothetical replacement asset.
- The hypothetical replacement asset is assumed to be constructed at the existing location of the road. The fact adjacent land has residential buildings is only relevant if any hypothetical replacement would necessarily use identical land.
- Including the cost of acquiring and demolishing residential buildings along the entire route of the road, would result in a value that does not reflect a hypothetical exit price for a road.

Site preparation costs already included

Professional judgement needs to be applied to consider whether fair values assigned to land, already include site preparation costs, explicitly or implicitly AASB 13.F12(b). Where this is the case, site preparation costs do not form part of the replacement cost of structures on that land. This is because a market participant would not incur those costs when constructing a hypothetical asset.

For example, where the fair value of land is estimated using the market approach, the cost of site preparation costs may be implicitly included, because the site is ready for construction. Entities should consider methods and assumptions used by the land valuers to assess whether the fair value of the land includes site preparation costs.

Other matters

The costs of demolishing of the reference asset itself should generally not be included in the replacement costs of the reference asset. This is because the current use is assumed to be the highest and best use, and it follows the hypothetical market participant would not therefore demolish the existing structures. For example, when valuing a hospital (the subject asset), the cost of demolishing this hospital should not be included in the replacement cost of the reference asset. The exception could be where the asset is planned to be sold or repurposed in accordance with AASB 13 para Aus29.1. An additional argument for this view is mentioned in AASB2022-10.BC177: 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. These costs would not merit inclusion in the asset's current replacement cost because the market participant buyer of the subject asset would not pay for those costs.

The entity should assume the asset will be constructed in its entirety rather than replaced on a piecemeal basis. If specific additional costs arising from piecemeal replacement of an asset are identifiable, they should be excluded from the estimate of the asset's current replacement cost (AASB 2022-10.BC192-193).