The Chartered Institute of Public Finance & Accountancy

IFRS 13 Fair Value Measurement – Local Authority Property Plant and Equipment

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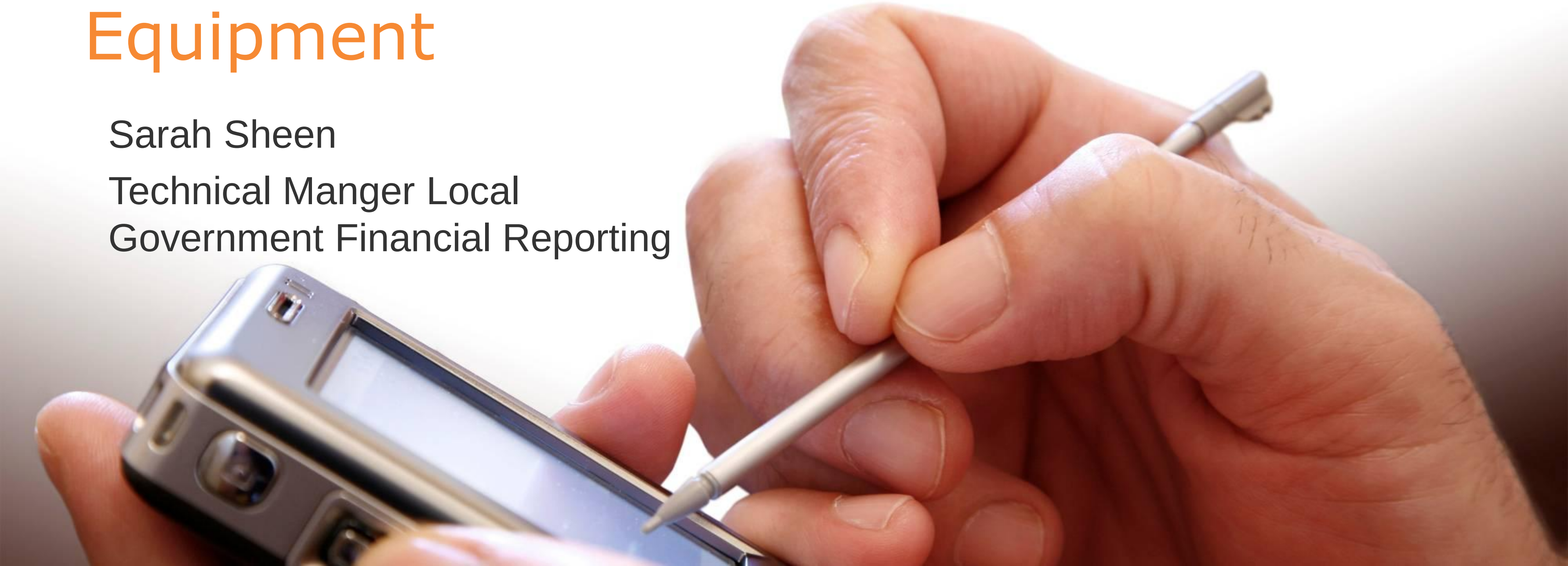

Recap - Definition of Fair Value

- IFRS 13 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
- For property, plant and equipment assets IFRS 13 requires that assets are measured at highest and best use.
- The entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value
- Applies when another standard refers to fair value

Recap - What does the Code currently say about PPE measurement?

- Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction. For this section of the Code [section 4.1], fair value (for land and buildings) is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a valuation on the basis of existing use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards

A reminder of the consultation proposals

IFRS 13 Routemap for Property, Plant and Equipment

Are there any constraints or restrictions on the disposal of the asset?

No - Route 1

Measure in accordance with the requirements of the standard ie at highest and best use eg office accommodation – administrative or surplus assets

Yes

Do these constraints or restrictions align with the restrictions in the standard (ie either the asset has unique characteristics or there are legal restrictions)?

Yes - Route 2

Unique Characteristics

Fair Value cost approach eg crematoria (or the income approach as appropriate)

Restrictions

Asset measurement at fair value limited to current or existing use eg schools or social housing

No

Does the authority have clear evidence that it is constrained by service needs to provide the asset in a particular location or is the asset's market restricted by geographical limitations?

Yes - Route 3

Measure at fair value limited to current or existing use in accordance with the (proposed) adaptation

What did the consultation paper propose?

- See previous slide for the overview of the consultation position per the Appendix A to the ITC on IFRS 13 - three routes - only one route (where local authorities use their assets in the same way as commercial entities) would require remeasurement.
- Developed the concept of restrictions in the standard mean that for route 2 assets fair value measurement would be limited to existing use – as a market participant would not be able to ensure that a market in highest and best use would be legally permissible - (thus measuring current capacity).
- Route 3 - tried to work with IFRS 13 whilst adding the conceptual approach ie that local authority financial statements try to measure the operational capacity and linked this with the constraints/restrictions principles in the Standard. Local authorities due to service and geographical constraints could not access the economic benefits available to private sector entities.

What has happened since? (1)

- Significant support for the adaptation in the consultation responses , although some contrary views – see report CL 10 11 13 Appendix A.

- Discussed at FRAB – HM Treasury paper indicated that application of IFRS 13 without the need for adaptation should capture geographical and service constraints (using the principles similar to route 2 in the Code consultation).

- CIPFA's response – not clear this is the case for some types of local authority assets and conceptually local authority financial statements have always sought to measure service potential - ie operational capacity of the assets a service uses (capital charges are applied to reflect the resources used).

What has happened since? (2)

- IASB Conceptual Framework discussion paper issued in July – sets out – use of an entry price (for example, replacement cost) might provide more relevant information when:
  - assets are held for use rather than for sale; or
  - exit prices are unavailable or do not reflect orderly transactions between willing buyers and sellers.

  (IASB Conceptual Framework Discussion Paper - Paragraph 6.50).

- October FRAB discussions – IFRS 13 sets out the principles of measurement when another standard requires a fair value but not primarily designed for valuing service potential.

- Conclusion – consideration should therefore be given to when to use fair / exit values – revisit IAS 16 Property, Plant and Equipment.

How should we measure Property, Plant and Equipment? (1)

- The primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of the public and eligible residents.

- Governments and other public sector entities are accountable to those that provide them with resources, and to those that depend on them to use those resources to deliver services during the reporting period and over the longer term.

- Measurement of property, plant and equipment – the UK public sector has always sought to measure the service potential or operational capacity of the assets utilised to deliver services for the users listed above.

How should we measure Property, Plant and Equipment? (2)

- Given the service objectives in (1) while the opportunity cost of holding assets in terms of the cash flows that could be generated through sale is useful information it should not be the primary driver of financial reporting
- Whilst highest and best use might be applied to individual assets how does this project theoretically to a portfolio of assets that are by necessity geographically constrained.
- Whilst the income and cost measurement approaches in IFRS 13 may capture the service potential they do so because this is a theoretical measurement having to be derived either because a market does not exist or cannot be accessed by the public sector entity.
- Highest and best use has balance sheet implications but what about the impact on the performance (statement) is it appropriate to charge services with the cost of using the asset in its highest and best use and not in accordance with how they use the asset? What about consistency with other revenue costs eg inventories? Issue raised by respondents to the consultation.

Proposed way forward: (1)

- Adopt measurement objective (could be based on current IPSASB draft Conceptual Framework objective)
- Maintain current IAS 16 adaptation by requiring measurement at current value
- So for operational assets values needed to **provide services directly to the public** the measurement should be based on **existing use value**.
- Assets not subject to service or other constraints should be measured at Fair Value under IFRS13.

Proposed way forward: (2) Measurement Objective

- Appendix to MoU between Relevant Authorities sets out approaches for implementing requirement in GRAA 2000 to apply IFRS adapted as necessary for the public sector context
- Allows consideration of other GAAP including IPSASB pronouncements if there are indicators of a potential need for adaptation - measurement of service potential in a non –current asset align with a number of the indicators.
- IPSASB Conceptual Framework likely to adopt term 'current value' and defining 'fair value' as method of determining exit or market valuations.
- Draft IPSASB CF Measurement objective :

  To select those measurement bases that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes

Proposed way forward (3): Assets not subject to constraints

- Office accommodation assumption, if an authority is able to take the same decisions as commercial entities, needs to measure the financial capacity of these assets and is not constrained by a need to measure the asset's operational capacity then these assets should be measured at fair value.

- Surplus assets not meeting the definition of assets held for sale no longer need to reflect operational capacity (as they are not operational) - should be measured as fair value under IFRS 13

Impact on classes of assets

Class/type	Measurement
Council Dwellings	Current value
Land and Buildings	Current Value and Fair Value (see next slide)
Vehicles, plant etc	DHC as proxy for Current Value
Infrastructure	DHC
Community Assets	DHC or Valuation (currently per FRS 30)
Heritage Assets	Valuation (currently per FRS 30)

Proposed way forward (4): Supplementary guidance needed

- Measurement techniques – to follow the same principles as IFRS 13 (market, income and cost approaches) and should maximise observable inputs
- Disclosures – Excluded from IFRS 13 in scope but could include the principles of IFRS 13 to support the current value measurement (and possibly add option for including a market valuation in the notes)
- Will need to establish a separate class /(es) of assets for assets needing to be measured at fair value as opposed to those measured at current value to support the principles of asset classification under IAS 16