



Project	Fair value measurement
Topic	Disclosing the current use of an asset if it differs from the highest and best use

Purpose of this paper

1. This paper addresses whether an entity should be required to disclose the reasons an asset is being used in a manner that differs from its highest and best use.
2. In IFRSs, this proposed disclosure would be required for assets measured at fair value for subsequent measurement in accordance with IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property*. In current US GAAP, this disclosure would apply to non-financial assets when testing for impairment. In addition, the disclosure could be required for investment properties when an Accounting Standards Update (ASU) on investment property is finalised.
3. This paper asks the boards:
 - (a) whether to retain the proposal to require an entity to disclose the reasons an asset is being used in a manner that differs from its highest and best use; and
 - (b) if so:
 - (i) whether the disclosure should also be required for fair value measurements that are disclosed in the notes; and
 - (ii) the scope of the disclosure.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

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4. The appendix to this paper describes the highest and best use concept.

Summary of the proposals

5. Paragraph 820-10-50-2E of FASB's exposure draft of a proposed ASU *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* states:

If the highest and best use of an asset differs from its current use, a reporting entity shall disclose the reason(s) that the asset is being used in a manner that differs from its highest and best use.

6. That proposal is identical to the IASB staff's draft of a forthcoming IFRS on fair value measurement posted to the IASB website in August 2010.
7. It is important to note that the basis for conclusions and the summary of the proposed ASU (although not the amendments to the Codification itself) state that the disclosure would be required when an asset is measured at fair value **in the statement of financial position**.

Overview of comments received

8. Although not specifically asked in the FASB's exposure draft, some respondents commented on the proposed disclosure. The FASB did not receive any comment letters from users of financial statements, but the staff has solicited feedback from users in developing this paper.

Comments received on the exposure draft

9. Some of the respondents who commented on the proposal support the proposed disclosure. They think it is important that users of financial statements know when an entity's business model differs from the basis for the amounts recognised in the financial statements. Those who support the proposal generally

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think the disclosure should be limited to real estate (not for all non-financial assets).

10. However, many of the respondents who commented on the proposal are concerned that such information might be misleading for users of financial statements (implying that management is not managing the assets at their highest potential) or might reveal proprietary information about the entity's intentions for its assets.

Discussions with users of financial statements

11. From our discussions with users of financial statements, the staff has learned that users would in fact find this information useful for non-financial assets (eg investment properties) for which fair value is used in their analyses (whether the fair value is recognised or disclosed). They said that when forecasting future cash flows, they would need to know what the assets are being used for and how that use fits with the entity's strategic and operating plans.

Staff analysis and recommendation

12. This section addresses:
 - (a) whether the disclosure should be required; and
 - (b) if so:
 - (i) whether the disclosure should also be required for fair value measurements that are disclosed in the notes; and
 - (ii) the scope of the disclosure.

Should the disclosure be required?

13. The staff thinks many of the concerns raised by respondents stem from misunderstandings about highest and best use. As discussed at previous board meetings (eg see Agenda Papers 2A (IASB)/3A (FASB) and 2B (IASB)/3B (FASB) from the February 2010 joint meeting), in most situations the current

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use of an asset will be its highest and best use. Agenda Paper 2B (IASB)/3B (FASB) from the February meeting stated that the current use and highest and best use of an asset rarely differ because:

- (a) most entities behave rationally and seek to maximise profits by operating their assets in their highest and best use;
 - (b) a proper assessment of highest and best use takes into account the following:
 - (i) all of the assets in the asset group, including intangible assets; and
 - (ii) the costs that would be incurred to convert the asset to an alternative use, including the risk and lost profits associated with converting the asset to an alternative use.
14. However, the staff and boards have been told that there are situations when the highest and best use and the current use of an asset are not the same. In such cases, the staff thinks it is important that users of financial statements be made aware of the fact that there is a difference for the reasons cited by users in paragraph 11.
15. Many respondents who commented on this proposal are concerned about the cost of providing information about why the current use of an asset differs from its highest and best use. However, when measuring fair value entities are already required to analyse whether an asset is being used at its highest and best use. In the rare situations when an entity concludes that there is a difference between the current use and the highest and best use of the asset (and the highest and best use of an asset has been correctly assessed), such information would be important for management. As a result, it seems that providing such a disclosure would not be incrementally costly.

Should the disclosure also be required for fair values disclosed?

16. As noted in paragraph 7 above, the basis for conclusions and the summary of the proposed ASU (not the amendments to the Codification itself) state that the

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disclosure would be required when an asset is measured at fair value **in the statement of financial position**.

17. The staff thinks the wording was intended only to make it clear that when an asset is measured at fair value, that fair value is based on the highest and best use of the asset, not the current use of the asset. The staff thinks the boards did not intend to limit the disclosure to assets measured at fair value in the statement of financial position.
18. The staff thinks the disclosure would be meaningful for users of financial statements that rely on fair value information, whether that fair value information is presented in the statement of financial position or is disclosed in the notes.

Scope of the disclosure

19. Some have suggested that the scope of the disclosure be limited to real estate assets (eg land and buildings). Although the highest and best use concept was originally developed for such assets, the staff thinks the disclosure should not be limited to them when the highest and best use concept applies to all non-financial assets.
20. In fact, the highest and best use concept arises for intangible assets that are being used defensively. Although intangible assets currently are not measured at fair value after initial recognition, the fair value measurement standard, as a principles-based standard, should not need to be amended in the future as the boards decide to use fair value as a measurement basis for particular assets or liabilities.

Staff recommendation

21. The staff recommends the following:
 - (a) require an entity to disclose the reasons an asset is being used in a manner that differs its highest and best use;

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- (b) also require the disclosure for fair value measurements that are disclosed; and
- (c) not limit the scope of the disclosure to particular types of non-financial assets.

Question 1

Do you agree with the staff recommendation in paragraph 21(a)?

If not, what do you propose and why?

Question 2

If the boards answered **Yes** to Question 1:

Do you agree with the staff recommendation in paragraph 21(b)?

If not, what do you propose and why?

Question 3

If the boards answered **Yes** to Question 1:

Do you agree with the staff recommendation in paragraph 21(c)?

If not, what do you propose and why?

Appendix

Master Glossary definition of Highest and Best Use

The use of a nonfinancial asset by market participants that would maximize the value of the asset or the group of assets and liabilities (for example, a business) within which the asset would be used.

Highest and Best Use

820-10-35-10A A fair value measurement of a nonfinancial asset considers a market participant's ability to generate economic benefit by using the asset in its **highest and best use** or by selling it to another market participant who will use the asset in its highest and best use. The highest and best use of the asset considers 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 consider when pricing the asset (for example, 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 consider when pricing the asset (for example, 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 consideration 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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- 820-10-35-10B** Highest and best use is determined from the perspective of market participants, even if the reporting entity intends a different use. However, a reporting entity's current use of an asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset.
- 820-10-35-10C** For competitive or other reasons, a reporting entity may intend not to use an acquired 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 reporting entity plans to use defensively by preventing others from using it. Nevertheless, the reporting entity shall measure the fair value of the asset assuming its highest and best use by market participants.