INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements

SUBMISSIONS RECEIVED

STAFF COLLATION OF RESPONSES TO CONCEPTUAL FRAMEWORK PHASE 3 CONSULTATION PAPER

List of Respondents:

Response #	Respondent Name	Country	Function
001	National Audit Office	Malta	Audit Office
002	Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)	Australia	Preparer
003	Ministry of Finance Ontario	Canada	Preparer
004	Swedish National Financial Management Authority	Sweden	Standard Setter/Standards Advisory Body
005	New South Wales Treasury	Australia	Preparer
006	Provincial Government of Newfoundland and Labrador	Canada	Preparer
007	The Institute of Chartered Accountants of Pakistan (ICAP)	Pakistan	Member or Regional Body
008	Institut der Wirtshaftprufer (IDW)	Germany	Member or Regional Body
009	The Institute of Chartered Accountants of Scotland	UK	Member or Regional Body
010	The International Consortium on Governmental Financial Management (ICGFM)	Supranational	Other
011	London School of Economics	UK	Academic
012	Accounting Standards Board	South Africa	Standard Setter/Standards Advisory Body
013	Swiss Public Sector Financial Reporting Advisory Committee	Switzerland	Standard Setter/Standards Advisory Body
014	Direction Générale des Finances Publiques	France	Preparer
015	Wales Audit Office	UK	Audit Office
016	Conseil de Normalisation des Comptes Publics (CNOCP)	France	Standard Setter/Standards Advisory Body
017	Public Sector Accounting Board (PSAB)	Canada	Standard Setter/Standards Advisory Body
018	Danish Agency for Governmental Management	Denmark	Preparer
019	Chartered Institute of Public Finance and Accountancy (CIPFA)	UK	Member or Regional Body
020	Joint Accounting Bodies	Australia	Member or Regional Body
021	Accounting Standards Board	UK	Standard Setter/Standards Advisory Body
022	Australasian Council of Auditors-General (ACAG)	Australia	Audit Office
023	Federation of Professional Councils of Economic Sciences (FACPCE)	Argentina	Other
024	United Nations Systems	Supranational	Preparer
025	Government of Canada	Canada	Preparer

Response #	Respondent Name	Country	Function
026	New Zealand Institute of Chartered Accountants	New Zealand	Standard Setter/Standards Advisory Body
027	Dr. Joseph S. Maresca	USA	Academic
028	Australian Accounting Standards Board (AASB)	Australia	Standard Setter/Standards Advisory Body
029	Cour des Comptes	France	Audit Office
030	Office of the Auditor General	New Zealand	Audit Office
031	Denise Silva Ferreira Juvenal	Brazil	Other: Accountant
032	Province of British Columbia	Canada	Preparer
033	The Japanese Institute of Certified Public Accountants	Japan	Member or Regional Body
034	Government of Nova Scotia	Canada	Preparer
035	Comptroller's Division of Manitoba	Canada	Preparer

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements

Specific Matter for Comment 1
Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

The role of the Framework is to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases. The specification of a measurement basis of assets and liabilities in financial statements should be the prerogative of individual Standards.

Alternatively, the Framework is to specify all measurement bases and concept and state that historical cost is the most commonly adopted basis in combination with other bases.

Specific Matter for Comment 2
If, in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?
Single Measurement Bases
(a) Historical cost.
(b) Market value.
(c) Replacement cost.
Combinations of Bases/Approach
(d) Deprival value.
(e) Historical cost and market value.
(f) Replacement cost and market value.
(g) Historical cost, replacement cost, and market value.
Others
(h) Another measurement basis or combination of bases/approach.
Please explain why you support a particular measurement basis or combination of measurement bases/approach and your reasons for rejecting alternatives.

NAO opines that all measurement bases and concept should be included in the Framework since each basis has its advantages and disadvantages and can be used in certain instances. In particular, the historical cost model and the deprival value model should be used in the Framework. The historical cost model is particularly important as it is the measurement basis which is mostly in use. The deprival value model is to be included as it does not specify one current cost model but indicates the current value that is most relevant to the situation. The remaining measurement bases (market value and replacement cost), although referring to current cost, have one measurement basis.

NAO rejects the alternative that some measurement bases are excluded since each measurement basis can be applied in relevant circumstances and therefore should be included in the Framework.

Specific Matter for Comment 3
The Consultation Paper discusses the following measurement bases: historical cost, market value, and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

Yes, NAO believes that the discussion is complete, balanced and fair and draws out the strengths and weaknesses of the various bases. One might perhaps include under the historical cost model the possibility of revaluing assets to their fair value.

A separate section might also be included to discuss the concepts of capital and capital maintenance and indicate more specifically and in greater length the effects of each measurement basis on the concepts of capital.

Specific Matter for Comment 4
In your view, should:
(a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and
(b) The effect of changes in own credit risk be reflected when liabilities are subsequently re-measured?

NAO opines that the effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition. It also believes that the effect of changes in own credit risk be reflected when liabilities are subsequently re-measured. Undertaking such an approach would enhance comparability of the financial statements.

Specific Matter for Comment 5
In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:
(a) Only the service potential relating to the existing use; or
(b) Include the incremental value relating to its possible sale for an alternative use?

NAO opines that where assets are not restricted in use and therefore may be sold for an alternative use, the measurement reported in the statement of financial position is to reflect only the service potential relating to the existing use. This is due to the fact that as

mentioned in the framework there must be strong evidence to support the possibility of a sale of the asset for the incremental value relating to its possible sale for an alternative use to be included.

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The Technical Director
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CANADA

Dear Sir/Madam

Consultation Paper "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements"

The Australian Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board in relation to the abovementioned Consultation Paper.

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The committee comprises the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC considers it would be far more effective for the IPSASB to first discuss and articulate which concept of capital (and/or capital maintenance) is most relevant for the measurement of assets and liabilities by public sector entities. Following on from that, HoTARAC believes the Framework should also articulate a single ideal measurement basis, to achieve consistency across financial statement items and comparability between entities across jurisdictions. In this respect, HoTARAC prefers the fair value measurement basis, as explained in Specific Matter for Comment 2.

HoTARAC notes the IPSASB's comment on page 4 of the Consultation Paper that "the purpose of the IPSASB's project is not to interpret the application of the IASB Framework to the public sector". However, no reasons have been given as to why the International Accounting Standards Board's (IASB) conceptual framework is so fundamentally unsuitable for public sector entities, that development of a separate conceptual framework for such entities is warranted. HoTARAC believes the IPSASB's "Process for Reviewing and Modifying IASB Documents" is applicable (at least in part) to the development of a conceptual framework – particularly if alignment (to the degree possible) with IFRS is to remain an objective.

HoTARAC's preference is that the IPSASB and IASB work more closely to achieve convergence of their respective conceptual frameworks and other pronouncements. Even if this would delay progress from an IPSASB perspective, HoTARAC believes such convergence would result in superior long-term outcomes for public sector entities globally. The greater the potential for divergence between pronouncements applicable to government business enterprises (GBEs) (issued by the IASB) and

pronouncements applicable to other public sector entities (potentially issued by the IPSASB), the more significant are the practical difficulties in preparing consolidated financial statements for a whole-of-Government reporting entity. HoTARAC recommends that the IPSASB communicate to constituents how and when it will address this obvious tension between standard-setter frameworks under which various public sector entities might operate.

In relation to the Specific Matters for Comment in the Consultation Paper, and certain other matters, Attachment A sets out HoTARAC's views.

Any queries regarding HoTARAC's views and recommendations on this Consultation Paper should be directed to Ms Sue Highland from Queensland Treasury on +61 7 3405 6064 or email to sue.highland@treasury.qld.gov.au.

Yours sincerely

for Grant Hehir

CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

10 June 2011

HoTARAC RESPONSE TO IPSASB CONSULTATION PAPER "CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS"

General comments

HoTARAC notes the IPSASB's comment on page 4 of the Consultation Paper that "the purpose of the IPSASB's project is not to interpret the application of the IASB Framework to the public sector". However, no reasons have been given as to why the International Accounting Standards Board's (IASB) conceptual framework is so fundamentally unsuitable for public sector entities, that development of a separate conceptual framework for such entities is warranted. HoTARAC believes the IPSASB's "Process for Reviewing and Modifying IASB Documents" is applicable (at least in part) to the development of a conceptual framework – particularly if alignment (to the degree possible) with IFRS is to remain an objective.

HoTARAC's preference is that the IPSASB and IASB work more closely to achieve convergence of their respective conceptual frameworks and other pronouncements. Even if this would delay progress from an IPSASB perspective, HoTARAC believes such convergence would result in superior long-term outcomes for public sector entities globally. The greater the potential for divergence between pronouncements applicable to government business enterprises (GBEs) (issued by the IASB) and pronouncements applicable to other public sector entities (potentially issued by the IPSASB), the more significant are the practical difficulties in preparing consolidated financial statements for a whole-of-Government reporting entity. HoTARAC recommends that the IPSASB communicate to constituents how and when it will address this obvious tension between standard-setter frameworks under which various public sector entities might operate.

On page 4 of the Consultation Paper, the IPSASB states it is considering the potential for convergence with the concepts underlying statistical financial reporting models in developing the Conceptual Framework. HoTARAC prefers that the focus instead be on the underlying conceptual merits for general purpose financial statements. However, should the IPSASB identify more than one approach as being suitable, HoTARAC would support selection of that basis that most closely aligns with the GFS statistical model.

HoTARAC notes that the IPSASB's Conceptual Framework project is stated as applicable to general purpose financial reporting (which is a wider concept than general purpose financial statements). However, the IPSASB's Consultation Papers for Phases 2 and 3 of this project appear to more directly relate to general purpose financial statements.

Further, in light of the IPSASB's arrangements for release of separate documents for each phase of its Conceptual Framework project, HoTARAC would prefer more clarity about how the finalised Conceptual Framework documentation will be issued e.g. will it be issued as –

- one inter-connected document with self-contained chapters for particular matters (e.g. elements and recognition, measurement etc);

- one document setting out the over-arching principles – which HoTARAC presumes relates to Phase 1 - with separate documents that deal with specific aspects (e.g. elements and recognition, measurement etc) but which are all subject to the over-arching principles; or
- some other arrangement.

Since some Conceptual Framework concepts (like measurement) could be applied beyond the boundaries of general purpose financial statements, HoTARAC recommends that the IPSASB clarify the application of all phases (particularly Phase 1) of its Conceptual Framework.

HoTARAC strongly recommends that the IPSASB's Conceptual Framework (as the term implies) be restricted to high-level principles that are appropriate to reporting by the broad range of public sector entities. HoTARAC believes that issues relating to the practical application of those high-level principles only be dealt with in IPSASs.

HoTARAC also recommends that the IPSASB clearly communicate to constituents how and when the eventual outcomes of the IPSASB's conceptual framework project will be reflected in existing IPSASs, to ensure consistency across all IPSASB pronouncements.

Specific Matter for Comment 1

Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

HoTARAC acknowledges the references in section 1 of the Consultation Paper to various concepts of capital, and the articulation of which concept of capital relates to each "measurement basis" as described in the paper. However, HoTARAC considers it would be far more effective for the IPSASB to first discuss each concept of capital (and/or capital maintenance) in some detail and articulate which one, in its opinion, is most relevant for the measurement of assets and liabilities by public sector entities. Such strategic discussion is fundamental to decisions about measurement bases and, accordingly, should have prominence in the Framework. This discussion should also clarify whether there are other objectives of measurement (e.g. to facilitate general user "understandability", comparability between private sector and public sector entities – particularly for those entities providing similar services e.g. schools, hospitals, transport - etc).

Following on from that, in addition to describing the underlying factors for selecting a measurement basis for assets and liabilities, HoTARAC believes the Framework should also articulate its opinion of the single ideal measurement basis, to achieve consistency across financial statement items and comparability between entities across jurisdictions. Taking the lead in this way will, in HoTARAC's view, elicit more meaningful future input from constituents by focussing attention on this crucial aspect of financial reporting.

Specific Matter for Comment 2

If, in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?

Single Measurement Bases
- *(a) Historical cost.*
- *(b) Market value.*
- *(c) Replacement cost.*

Combinations of Bases/Approach
- *(d) Deprival value.*
- *(e) Historical cost and market value.*
- *(f) Replacement cost and market value.*
- *(g) Historical cost, replacement cost, and market value.*

Other
- *(h) Another measurement basis or combination of bases/approach.*

Please explain why you support a particular measurement basis or combination of measurement bases/approach and your reasons for rejecting alternatives.

In light of inconsistencies in meaning of terminology used by other professional bodies and standard-setters (e.g. as used by the International Valuation Standards Council (IVSC) and IASB), HoTARAC believes readers may have differing interpretations of what is a "measurement basis". HoTARAC therefore strongly recommends that the IPSASB clearly articulate the difference between a measurement basis, proxy, valuation technique etc. For example, "replacement cost" is generally considered to be one potential proxy for "fair/market value" in circumstances where there are no observable market transactions for the particular asset, rather than being a measurement basis itself.

As indicated in response to Specific Matter for Comment 1, HoTARAC believes the Framework should articulate its opinion about the single ideal measurement basis. However, HoTARAC does not believe the discussion in the Consultation Paper is sufficiently robust to support the selection of an ideal measurement basis.

HoTARAC prefers the fair value measurement basis, as defined and applied by the IASB (e.g. as anticipated in the IASB's new standard IFRS 13 *Fair Value Measurement*).

Fair value is a widely used and widely understood measurement basis in financial accounting. It is generally more relevant for evaluating and making economic and other decisions by diverse groups of users, despite any costs involved in ascertaining fair value. HoTARAC considers fair value generally meets most of the proposed qualitative characteristics of financial information as described in the IPSASB's Phase 1 exposure draft. "Fair value" is also already used in various IPSASs.

The use of fair value as the ideal measurement basis for public sector entities would also reduce the administrative burden for preparers as fair value aligns with –

- the use of market value for IMF/GFS measurement purposes; and
- the use of fair value by the IASB (applied by public sector GBEs).

HoTARAC's response to Specific Matter for Comment 3 also refers to the need to deal with "fair value" in the Framework.

Regarding the Consultation Paper's general discussion, the points in paragraph 1.7 about historical vs current values, entry vs exit (including net selling price) values, and entity-specific vs market-based values, should be expanded to debate the relative merits of such aspects in the context of financial reporting by public sector entities.

Other matters that HoTARAC believes should be addressed in the Framework include –

- whether values should be determined on a stand-alone basis, or on the basis of being used in conjunction with other assets/liabilities;
- acknowledgement that the more objective (verifiable) the measurement inputs are, the better is the measurement outcome; and
- how to deal with situations in which the single ideal measurement basis is not appropriate or practicable.

Specific Matter for Comment 3

The Consultation Paper discusses the following measurement bases: historical cost, market value, and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

HoTARAC has a range of concerns with the Consultation Paper's discussion about the various "measurement bases", as explained below.

General

As mentioned in response to Specific Matter for Comment 2, HoTARAC believes there is confusion in the Consultation Paper about what is a "measurement basis". HoTARAC therefore strongly recommends that the IPSASB clearly articulate the difference between a measurement basis, proxy, valuation technique etc and re-structure the Consultation Paper accordingly.

The discussion of each "measurement basis" should include a detailed assessment against the proposed objectives of financial reporting, and against each of the proposed qualitative characteristics and constraints of financial information (which may also inform the final determination of the IPSASB's qualitative characteristics of financial information). All discussion needs to debate the relative merits from both an asset and a liability perspective.

Such analysis is necessary for an informed determination of the ideal measurement basis, bearing in mind the inevitable need for trade-offs between qualitative characteristics. It would also better support the IPSASB in deliberations at the standards "level" relating to assets and liabilities, and would provide useful conceptual guidance for preparers and users of public sector entities' general purpose financial statements.

In addition, Appendix B would be enhanced if it included realistic illustrative examples demonstrating how "highest and best use" would be applied to determine values for individual assets (refer to the response to Specific Matter for Comment 5).

HoTARAC recommends that the IPSASB discuss, and take a position on, the preferences between different valuation techniques (where there is a practicable choice for an asset or liability). It would be expected that such a position would take into account factors like the relative objectivity of the required measurement inputs (similar to the three level hierarchy the IASB has determined for fair value measurement). If the IPSASB decides not to deal with this aspect, HoTARAC recommends that it explain its rationale for not doing so.

HoTARAC urges the IPSASB to review the presentation of material in the Framework about each measurement basis. In this regard, the structure of each section should be consistent to avoid perceptions of bias in the arguments for and against the differing measurement bases (despite the comments in paragraph 1.10 of the Consultation Paper). Further, given the varying depth of experience between government jurisdictions regarding the full range of measurement bases, there is worth in ensuring the Framework contains robust discussion of each measurement basis (regardless of assumed familiarity with certain concepts).

Consistent with certain "General comments" at the beginning of this response, the Consultation Paper (in paragraph 1.2) expresses the IPSASB's desire for measurement bases to be consistent with those used for statistical purposes (e.g. as enumerated in the Government Finance Statistics Manual 2001). As general purpose financial reporting is intended to cater for a broad range of users, HoTARAC questions the appropriateness of consistency with GFS being a primary consideration. The GFSM 2001 deals with statistical concepts that are designed for macro-economic analysis and require specialist knowledge. Those concepts are not intended for use by the broad range of users of general purpose financial statements of public sector entities. Therefore, HoTARAC prefers that the focus instead be on the underlying conceptual merits of measurement bases for general purpose financial statements. However, should the IPSASB identify more than one measurement basis as being suitable, HoTARAC would support selection of that basis that most closely aligns with the GFS statistical model.

The second sentence of paragraph 1.6 refers to assets being "reported on the same basis where circumstances are similar". However, as HoTARAC considers that principle should also apply to liability measurement, that sentence should also refer to liabilities.

Paragraph 1.17 states that for the proper assessment of accountability it is important that assets are not understated and liabilities are not overstated. However, HoTARAC believes the Framework should be clear that it is equally important to ensure that assets are not overstated and that liabilities are not understated.

Paragraph 2.2, the first bullet point of paragraph A3, and the last sentence of paragraph 5.45 in the Consultation Paper imply that recognition of a liability is preceded by the direct receipt of consideration. However, HoTARAC would argue that this is not always the case (e.g. in the case of many provisions), and therefore strongly recommends that the IPSASB ensure its discussion in the Framework is comprehensive i.e. that it is equally applicable to all types of liabilities.

Historical cost

HoTARAC questions the reference in paragraph 2.2 of the paper to discounting a liability to present value. In HoTARAC's view, discounting of future cash inflows and outflows does not fall within the historical cost measurement basis. Historical cost should either be the historical acquisition cost (for an asset), or the nominal amount previously agreed to pay in the future (for a liability).

Therefore, HoTARAC believes the Framework should deal with income-based (e.g. "present value") valuation approaches in a separate section. This separate section should include discussion about the application of discounted cash flow techniques in public sector contexts, including where an entity may be operating in a rate-regulated industry (where the amount of cash inflows is restricted).

The Consultation Paper raises subjectivity concerns (in paragraph 2.7) about attributing transaction costs to an asset, allocating overheads to constructed assets, and allocating historical costs to individual assets acquired in a "basket" transaction. The IPSASB appears to acknowledge that these issues also apply under other measurement bases. However, in the interests of a complete and balanced discussion of each measurement basis, HoTARAC recommends that the IPSASB elaborate on why those matters "are particularly relevant to an assessment of the usefulness of historical cost", and why those issues are less of a concern under other measurement bases. Further, the issues about depreciation mentioned in paragraph 2.8 also apply to other measurement bases. Therefore, in the interests of a balanced discussion, HoTARAC recommends that these issues either be omitted from the historical cost discussion, or referred to under each measurement basis.

Market value

The Consultation Paper discusses the concept of "market value", and refers to the IVSC definition of "market value" in paragraph 3.2. This raises the following related issues –

- the IPSASB's standards instead deal with "fair value" (e.g. in IPSAS 17 *Property Plant and Equipment*, IPSAS 28 *Financial Instruments: Presentation* etc);
- the IVSC separately defines "market value" and "fair value" which result in different measurements. The IVSC definition of market value aligns with the IASB concept of "fair value", and (presumably) the use of "fair value" in existing IPSAS. However, the IVSC concept of "fair value" does not align with

the IASB concept of "fair value" (nor, presumably, with the use of "fair value" in existing IPSAS); and

- the IVSC's concepts are applied in a broader range of contexts than just financial reporting and, therefore, care needs to be taken in incorporating IVSC concepts into financial reporting pronouncements.

Therefore, HoTARAC recommends that the IPSASB Framework deal explicitly with the "fair value" measurement basis, including specifying its definition for financial reporting purposes, and how the use of "fair value" in IPSAS relates to the term "market value" (if "market value" is retained as a "measurement basis" in the Framework). Care is urged to ensure consistency of measurement consequences between the Framework and individual IPSAS. The discussion about "fair value" should address the same issues as recommended for the other "measurement bases" (e.g. detailed assessment against the proposed objectives of financial reporting, against each of the proposed qualitative characteristics and constraints etc). The IPSASB also needs to consider and articulate the relationship between "fair value" and associated techniques like "replacement cost", "discounted cash flow" etc.

The Consultation Paper indicates that a deep and liquid market is ideally needed for market values before a market value based measurement can be used (refer to page 8, footnote 11 on page 20 and paragraph 3.11). HoTARAC recommends that the discussion of the relative merits of "market value" deal with the consequences of such a limitation for public sector entities, given many of their assets and liabilities would not have a deep and liquid market.

Paragraph 3.13 refers to dams and reservoirs providing services that would not be provided by non-public sector entities. As such an assumption doesn't hold true for all government jurisdictions, HoTARAC recommends changing these examples to assets like military assets and national parks.

HoTARAC questions the last sentence in paragraph 3.8, since market/fair values are already a widely accepted feature of financial reporting. Any such perceived presentation difficulties have been overcome by the IFRS and GFS reporting frameworks via the use of the presentation classifications of "other comprehensive income" and "other economic flows", respectively, to avoid such market/fair value changes impacting directly on the reporting entity's operating surplus/deficit.

Replacement cost

As replacement cost is usually viewed as a proxy for "fair value" measurement, HoTARAC suggests that the IPSASB consider and articulate the relationship between "replacement cost" and "market value", if "market value" is retained as a measurement basis in the Framework.

HoTARAC notes the comment in paragraph 4.7 about replacement cost being an entity-specific measurement, and the paragraph 4.16 concerns about replacement cost prejudicing the proposed qualitative characteristics of timeliness, comparability and verifiability. However, in HoTARAC's experience, inputs to replacement cost measurements can in fact be market-based, and replacement cost determinations can be made by external professionals and can be audited. Replacement cost may

also reflect the views of market participants, who would be unlikely to pay more for an asset than the cost of replicating its service potential.

Also, HoTARAC recommends that the discussion about replacement cost examine whether and how different entity circumstances impact on the costs that should be included in the replacement cost (borrowing costs, for example).

The discussion about replacement cost would benefit from comparing and contrasting "replacement cost" and "reproduction cost", and in clarifying whether there are any circumstances in which these would produce the same valuation.

HoTARAC questions the concerns in paragraph 4.17 about the application of replacement cost to assets that may be sold for an alternative use. Consistent with HoTARAC's overall comments on this Consultation Paper, decisions in this regard need to be made in the context of the concept of capital that is concluded to be most appropriate to public sector entities. On that basis, HoTARAC considers the conceptual debate about alternative uses be included in the Framework, rather than in the development of specific IPSASs.

Deprival value

The second sentence of paragraph 5.3 refers to the use of historical cost where value in use is unverifiable. However, as historical cost does not appear to have a place (in subsequent measurement) under the deprival value model, it is recommended that that sentence be clarified. For example, should paragraph 5.3 instead refer to "replacement cost", consistent with the second sentence of paragraph 5.11?

HoTARAC recommends that the IPSASB review or clarify the comments in paragraph 5.24. In particular, the last sentence does not appear to be consistent with sub-paragraphs (a) and (b). To address this issue, should sub-paragraph (a) instead read "Cannot be lower than the minimum value that the entity can derive ..."?

Footnote 28 and paragraph 5.47 refer to serious practical problems in using an assumption price, but these problems do not appear to be explained. In the interests of ensuring a robust debate about the merits of various measurement concepts, HoTARAC recommends that there be further examination of these "serious problems" within the Framework.

HoTARAC also recommends that the last phrase of paragraph 5.34 be clarified, as it is reasonable to expect that the cost of fulfilment would generally reflect the carrying amount of resources to be used.

Specific Matter for Comment 4

In your view, should:

(a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and

(b) The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured?

HoTARAC notes that the concept of "own credit risk" is not currently dealt with in any IPSAS. Also, HoTARAC questions the need to deal with this detailed issue in a high level Conceptual Framework. If the IPSASB decides to introduce this concept into its pronouncements, it would need to provide more guidance about this concept, including how to identify and quantify changes in "own credit risk".

(a) Subject to the above comments, provided the measurement of the liability is based on a fair/current value, HoTARAC supports inclusion of an entity's own credit risk in measurement at initial recognition. However, even where measurement is based on a fair/current value, HoTARAC does not support the separate identification of "own credit risk" as distinct from the overall basket of risks that may be reflected in the measurement of a liability, due to difficulties in measurement and verification of that component separately.

(b) Provided the measurement of the liability is based on a fair/current value, HoTARAC supports recognition of the effect of changes in an entity's own credit risk. However, paragraph A6 refers to the recognition of a gain if an entity's credit risk has deteriorated and recognition of a loss if the entity's credit risk improves. HoTARAC is firmly of the view that the effects of such changes should not impact on the measurement of an entity's surplus or deficit, as this is counter-intuitive and potentially misleading.

Other comments about Appendix A

Footnote 27 explains that the discussion about credit risk is only described in relation to the entity as a whole, for simplicity. However, as acknowledged in footnote 27, in practice, credit risk would be dealt with in relation to specific liabilities (as risks of non-performance may vary, depending on the nature of the liability). HoTARAC considers it would be more complete if the IPSASB's analysis and discussion of credit risk deals with the various liability contexts that may exist (e.g. an obligation to pay cash vs an obligation to undertake an activity). This may better identify any issues with recognising the effects of changes in an entity's own credit risk.

HoTARAC questions the assertions in paragraph A7 that the values of an entity's assets and liabilities would necessarily fall when its financial condition deteriorates. Provided the entity is still considered a going concern, this is not necessarily the case. An asset or liability's recognised value, and the ability to adjust its value, ultimately are governed by its measurement basis and associated accounting standards. For example, paragraph 69 of IPSAS 29 *Financial Instruments: Recognition and Measurement* states "A downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information". The usefulness of referring to losses

that may not be recognized in financial statements is also questioned, as this debate should focus more broadly on the conceptual rationale for amounts that are reflected in a reported financial position, and the relationships between those amounts.

HoTARAC agrees with the point made in the last sentence of paragraph A10 that only very rarely would a public sector entity be allowed to redeem a liability for less than is contractually due, and considers this is an important point in the debate about the merits of recognising the effect of changes in credit risk.

Further, paragraphs A3, A5 and A12 refer to how an entity's credit risk would affect the amount that is received in exchange for the liability's issue. Even in those situations where a liability is preceded by the direct receipt of money, this may not always be the case for individual public sector entities (where non-commercial transactions are more common).

Specific Matter for Comment 5

In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:

(a) Only the service potential relating to the existing use; or

(b) Include the incremental value relating to its possible sale for an alternative use?

As mentioned earlier in this response, HoTARAC believes the IPSASB should first discuss and articulate which concept of capital (and/or capital maintenance) is most relevant for the measurement of assets and liabilities by public sector entities. HoTARAC also believes the Framework should also articulate the ideal measurement basis.

These factors would influence the decision about which of the two options in Specific Matter for Comment 5 is the most appropriate. Subject to this, HoTARAC considers it more appropriate that an asset's value reflects its highest and best use (i.e. option (b)), as the highest and best use of an asset would generally be taken into account by most market-oriented measurement approaches. In this respect, HoTARAC questions the benefit of separately identifying the component reflecting the incremental value, due to difficulties in separately verifying such incremental value.

In addition, Appendix B would be enhanced if it included realistic illustrative examples demonstrating how "highest and best use" would be applied to determine values for individual assets, including where assets are used in conjunction with other assets. For example, where the highest and best use of a property (comprising land and a building) would be to demolish the building and sell the vacant land, how would the entity ascribe values to both the land and existing building?

Other comments about Appendix B

A point that needs to be borne in mind is that public sector entities often hold assets of a specialised nature, and/or in a location, that makes it difficult to identify all alternative uses. Therefore, HoTARAC recommends that any assessment of highest

and best use be based on a reasonable (rather than exhaustive) search for alternative uses.

Paragraph B4 suggests that an alternative use should only be reflected in an asset's value where there is a high degree of evidence to support it. HoTARAC supports this, but believes the point of a planned disposal is too late for the purposes of providing useful information for decision-making. More timely information throughout an asset's life about the value inherent in alternative uses would be more useful for ongoing decision-making about retention of the asset for its existing use vs conversion of the asset for an alternative use vs disposal.

Editorial matters

Paragraph 1.7 – the discussion in the second bullet about exit values needs to be enhanced to deal with exit prices for liabilities also.

Paragraph 1.9 – amend end of second sentence to read " ... those reported in the statement of financial performance ~~statement~~ is transparent."

Footnote 10 (to paragraph 3.3) – should be amended to read " ... on the concept of fair value, defines fair value as an exit value, based on market participants' perspectives, and prescribes that it is not adjusted for transaction costs, but is adjusted for transportation costs".

Footnote 14 (to paragraph 3.13) – last sentence should be amended to read " ... may be materially affected by the terms of such conjectural arrangements, and can vary greatly between different Service Concession Arrangements."

Paragraph 4.10 – small deletion required in middle of second sentence to read " ... depreciation of replacement cost represents ~~a~~ fairly the cost of ...".

Paragraph A12 – small deletion required in first sentence to read " ... when a liability is issued for a consideration ..."

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Ontario

June 22, 2011

Ms. Stephanie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario
M5V 3H2

Dear Ms. Fox:

Thank you for the opportunity to comment on the International Public Sector Accounting Board's Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements. I also appreciate you granting us an extension to June 22nd to submit, which allowed us to fully brief our executive management team.

In our response to the specific questions in the Consultation Papers and the Exposure Draft on the conceptual framework, the following key issues appear:

1. The IPSASB conceptual framework needs to specifically address the role of government and the accountability it has to the public. The conceptual framework needs to acknowledge the existence of constitutional and legislative structures that exist which can impact how governments should report.
2. The IPSASB conceptual framework should be limited to supporting the preparation of General Purpose Financial Statements (GPFS) that meet the informational needs of the general public and not try to encompass broader financial reporting.
3. The conceptual framework should recognize and support the financial accountability relationship governments have to the public, and not try to change the relationship by implementing a sector neutral approach for financial reporting.
4. The public sector in Canada is driven by balanced budget concepts and delivering appropriate services to the public, and not the accumulation of equity or profit maximization. As a result a revenue/expense approach to measuring government performance aligns best with the objectives of GPFS users in the public sector.

.../2

5. The primary users of public sector financial statements need clear and understandable information to gauge a government's performance against approved budgets. GPFS are a cornerstone in accountability reporting showing how the government balanced inflows with outflows of resources. Historical cost provides reliable measurement and faithful representation of government's use of resources, and supports the accountability relationship the government has with the public.

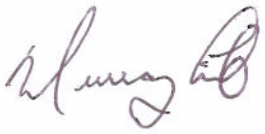
The historic cost basis of measurement is required to produce reliable accountability reporting on the way the government has fulfilled their duty to the public. The accountability relationship between the government and the public is related to managing expenses for delivering services within the revenues available, and not the accumulation of value on the balance sheet. As a result, any basis of measurement but historical cost would not be aligned to the role of government.

Specific responses to the detailed questions in the Consultation Paper are included in the attachment to this letter.

I should point out that the jurisdictions across Canada established a Joint Working Group to advise PSAB on the requirements for a public sector conceptual framework for Canadian governments. This project continues through the development of the required framework. I understand PSAB has provided input in the development of the IPSASB framework and I expect that the Joint Working Group's comments have been appropriately considered.

We thank you again for the opportunity to comment on the IPSASB Consultation Paper.

Yours sincerely,



Murray Lindo
Assistant Deputy Minister & Provincial Controller (Acting)
Office of the Provincial Controller Division

Attachment

c. Peter Wallace, Deputy Minister of Finance
Greg Orencsak, Associate Deputy Minister,
Office of the Budget and Treasury Board

ATTACHMENT

Specific Matter for Comment 1:
Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

Comments:
It is Ontario's position that the Framework should specify a single measurement basis for assets and liabilities, which is primarily historical cost, as this best reflects the reality of the public sector environment and supports quality financial reporting that meets user needs. The introduction of alternative bases of measurement would introduce unnecessary and inappropriate complexities into government financial reports which would not be easily understood by the general public users of GPFS, thus reducing the transparency and accountability of government reports. Allowing a choice of basis of measurement could result in inconsistent choices by different jurisdictions and public sector organizations, impairing comparability and consistency. It would also adversely impact accountability in public sector financial reports, as alignment between fiscal policy frameworks (where summary budgets and estimates are based on historical cost) and historical financial reports would be eroded.

Specifying historical cost as the appropriate measurement is generally consistent with the Public Sector Accounting Board's (PSAB) current conceptual framework, with the exception of impairments of cash generating financial assets or financial instruments. While PSAB has recently finalized its financial instruments standard, the new requirements recognize the importance of retaining the integrity and consistency of the statement of operations to achieve transparency and accountability in public sector reporting, and the importance of faithful representation in public sector financial reports. As a result, all unrealized gains and losses for financial instruments are reported in a separate statement that does not impact the statement of operations. Since governments do not operate in a speculative manner, and actual-to-budget comparisons are an important accountability mechanism for the public, PSAB's approach recognizes the importance of the yearly surplus/deficit measure and reports the gains/losses separately outside the statement of operations. Ontario supports unrealized gains and losses for the public sector to be reported in the notes to the financial statements.

Specific Matter for Comment 2
If, in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?

.../2

Single Measurement Bases

(a) Historical cost.
(b) Market value.
(c) Replacement costs.

Combinations of Bases/Approach

(d) Deprival value.
(e) Historical cost and market value.
(f) Replacement cost and market value.
(g) Historical, replacement cost, and market value.

Others

(h) Another measurement basis or combination of bases/approach.

Please explain why you support a particular measurement basis or combination of measurement bases/approach and your reasons for rejecting alternatives.

Comments:

Ontario prefers the approach taken by the PSAB handbook. Specifically, the Framework should specify historical cost as the primary measurement basis for assets and liabilities and use other bases of measurement only in specified circumstances, which would be generally restricted to:

(a) Valuation allowances used to reflect a reduction in the net recoverable value of a monetary asset;
(b) Estimation (including annual re-assessment of estimation) of the amount of a liability at the reporting date using present value techniques (e.g., employee future benefits or landfill); and,
(c) Monetary assets and liabilities denominated in foreign currency measured at the exchange rate at each reporting date (re-estimation of the local currency equivalent).

Rationale supporting primary historical cost basis:

- Using a historical cost-based measurement model is prudent and conservative and is consistent with the nature of the environment in which governments/public sector entities operate.
- A historical cost-based measurement model for assets and liabilities will be more easily understood by the public.

.../3

- Using historical cost based measurement will ensure transparency and accountability of government financial reporting (alignment between summary budgets, estimates and financial statements).
- The public relies upon information in the government's financial reports to assess whether the budget is balanced and if public services are delivered efficiently. The information presented on historical cost basis better serves these user needs (aligned with the basis upon which the government's budget is prepared).
- Where appropriate, information regarding the market value and risks related to items included in the Statement of Financial Position (e.g. financial instruments) may be provided through the Notes to the Financial Statements, as notes are integral to the financial statements and provide significant information to users.
- Budget to actual presentation/comparison on the historical cost basis is faithful representation.
- Cost is relevant when providing accountability to the public for the resources of government including tax dollars.

Rationale rejecting market value basis:

- Government's main accountability to the public is for results against budget, and the yearly surplus/deficit, which is based on legislative budget authorization, and not temporary market fluctuations.
- IPSAS 24 acknowledges the Budget as a key accountability report. As noted, Budgets would not include any projections of unrealized gains/losses, and therefore the comparability of the budget to actual results would be difficult for the user to understand. As it is written, the standard would require the actual results to be restated to the same basis upon which the budget was prepared for purposes of comparison. If we understand the Consultation Paper's intent, this would essentially result in two sets of books for actual results. Transparency and accountability in reporting will be negatively impacted to the extent that it is difficult to understand the two different sets of reports.
- The market value basis does not reflect the economic substance of a government's underlying transactions, since governments generally do not hold assets with the intention of selling them, take speculative positions, nor do they generally seek holding gains or losses.
- The introduction of a fair value approach on government financial reports impacts the quality of public sector reporting. This does not provide users of government financial statements with meaningful and relevant information on achieving their budget, and introduces complexities which would not be understood by the average user.

.../4

- Including unrealized market value gains or losses in government financial statements may reduce users' understanding of government finances or performance against budget, and may also impact fiscal policy decisions if the unrealized gains are misunderstood as being available to fund future programs (or conversely if unrealized losses are misunderstood as resulting in a reduction in funds available for programs).
- In Canada, PSAB requires that the budget be compared to actual in the government's financial statements. Since unrealized gains and losses would not have been included in the budget, the recognition of unrealized gains or losses on the statement of operations would cause difficulties in explaining differences between the budget and actual year end financial statement results, eroding user understanding of the financial results.
- The approach taken in the private sector to diverge from historical cost basis supports private sector financial statement users who are interested in the accumulation of value for an economic return. Since the users of public sector financial statements have different needs relating to achieving the legislatively approved plans for the government, the changes in the private sector should not influence public sector reporting.
- The practicality and timeliness of producing audited financial statements should also be a consideration. With the introduction of an alternative basis of measurement, incremental time, effort and cost on the part of preparers and auditors would be necessary, impacting the timeliness and cost of government financial reporting with no added benefit to the user.
- Senior Canadian governments have long argued that market value for derivatives is not appropriate for the public sector.
- Market value approach would not lead to better information for users to assess government performance or to better fiscal policy decision making.

Specific Matter for Comment 3:
The Consultation Paper discusses the following measurement bases: historical cost, market value, and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

Comments
In general, we think that the discussion presented in the Consultation Paper is balanced and fair. We have noted however, the following specific concerns:

The Consultation Paper states that "in general, fixed assets are most effectively valued when the current written-down replacement cost is used as a proxy for the current market value". This reflects a balance sheet approach as followed by the private sector. As stated previously, Ontario believes that historical costs best serves the needs of users of public sector financial statements – the public and the legislature acting on their behalf. The Consultation Paper contends that depreciation of replacement cost represents fairly the cost of an asset's services consumed within an accounting period. However, the Consultation Paper does not work through the issues to determine how the proposals would impact public sector financial statements and public policy decisions (i.e. tax policy). For example, the distinction is made between replacement cost and reproduction cost by making reference to elaborate fireplaces and plasterwork, assumedly from historical buildings, which do not add to the service potential. However, they fail to recognize that, in the public sector, assets are routinely used well beyond their useful lives or are retained for other purposes.

Unlike the private sector where users are seeking information on which to base resource allocation decisions, the users of government or public sector reports are seeking information to assess government performance against commitments (fiscal accountability). The suggested application of private sector concepts to the public sector is inappropriate.

The Consultation Paper does not address considerations such as cost vs. benefit of its proposals, nor the impact of the proposals on the balance of qualitative characteristics of public sector financial statements. For example, the impact of a change to replacement value upon predictive value or the quality of information for accountability reporting purposes is not discussed.

In conclusion, only historical costs align with the accountability model for government to the public and the needs of GPFS users. Ontario can only support the historic cost model for GPFS.

Specific Matter for Comment 4:
In your view, should:

(a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and

(b) The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured?

Comments

We believe that an entity's own credit risk should be reflected in the measurement of the liabilities at initial recognition. Reflecting subsequent changes in credit risk is not appropriate in the public sector because of the following considerations:

.../6

- It has limited significance in the public sector context because users of GPFS are not assessing a risk-based return on investment and governments are held accountable for realized gains and losses.
- For those governments which have encountered reduced credit risk, there are superior indicators that exist to reflect credit risk. The publication of the government's credit rating would provide the same informative value without any corresponding confusion and misunderstanding by the public for information presented in GPFS.
- It is extremely unlikely that the public sector would be able to take advantage of any decline in its credit risk.
- It does not support accountability reporting framework for the public sector.
- It contradicts going-concern concept.
- Increasing attention is being paid to the quality of credit ratings as evidenced by the SEC's recent initiatives.

In addition, due to the low credit risk of governments in Canada this is not seen as a significant issue.

Specific Matter for Comment 5:
In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:

(a) Only the service potential relating to the existing use; or
(b) Include the incremental value relating to its possible sale for an alternative use?

Comments

As noted earlier, Ontario believes that the conceptual framework should focus on supporting quality financial reporting that best serves user needs and that historical cost is the appropriate basis of measurement. Assets that have service capacity should not be revalued if it continues to have service capacity for the existing or an alternate government use. It would be inappropriate to report any incremental values until realized or decremented value until actions to sell the asset are actually taken by the government.

An event is needed, to confirm or solidify a change in value, and this would be related to impairment. Any divergence from historical cost as the basis for measurement conflicts with the accountability of governments to the public and will also increase risk in completing and auditing the financial statements on a timely basis, which is important due to the government fiscal planning cycle.

EKONOMISTYRNINGSVERKET

Date
June 22, 2011
Your date

Reference number
51-785/2011
Your reference number

Our reference
C-G Gustavsson

Comments on Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements

The Swedish National Financial Management Authority (ESV) appreciates the opportunity to comment on the Conceptual Framework.

ESV is the government agency responsible for financial management and development of GAAP in the Swedish central government. Full accrual accounting was introduced in 1993 and we hope that our experience will be a contribution in your work with various accounting issues.

Specific Matter for Comment 1

In our opinion the role of the Framework should be to identify relevant factors. In that perspective we find additional factors relevant which we discuss later, see matter 2.

Specific Matter for Comment 2

Even if we see the role of the Framework to identify factors that are relevant in selecting measurement basis we have strong beliefs regarding the choice of measurement basis. In our point of view there is a need for the use of combination of the bases and the approach.

We are of the opinion that the historic cost basis is the most relevant for assets used in the production of goods and services. In our opinion the value should reflect the financial sacrifices connected to the use of an asset, mainly when we talk about non exchange situations, which at least in Sweden is the basic situation in the public sector. These are best reflected in the historical value spread over time with depreciation. Comparability is achieved in the meaning that different circumstances when it comes to really accomplished outlays are reflected. For the purpose of financial position there are possibilities to use complementary information based on for example market value or replacement cost. For price calculations you need not be dependent solely on accounting figures.

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We see market value at assets used in the production as a relevant basis for prospective information and for some comparisons but these ends can be achieved with complementary figures. On the other hand market value does not reflect the financial sacrifice. Market value is also to be preferred when it comes to assets held for investment purposes. That is often the same with financial liabilities traded on the market.

In situations where there are no market values replacement cost is a relevant measure.

Finally, deprival value may be relevant when it comes to write-down requirement considerations.

Specific Matter for Comment 3

We believe that the discussion lack the perspective of financial sacrifices as a relevant perspective when it comes to assets used in the production of goods and services.

Specific Matter for Comment 4

Our answer is no to both questions.

Specific Matter for Comment 5

Even if it would be possible to use an asset differently, including selling it, we have the basic assumption that assets are held for production purposes. From that point of view we conclude that taking higher (or lower) sale values into the accounts would not reflect the actual financial sacrifices associated with the assets. We therefore support point a).

Concluding remarks

We hope the comments given will be useful in your continuing work. We would like to take this opportunity to express our support for the development of International Public Sector Accounting Standards and a framework for financial reporting.

Curt Johansson and Claes-Göran Gustavsson have prepared the comments given in this report.

EKONOMISTYRNINGSVERKET

Yours sincerely,

Ingemar Härneskog

Deputy Head of Department,
Department of Central Government Accounting and Finance

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NSW GOVERNMENT | The Treasury

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2 CANADA

Contact: R. Williams
Telephone: (612) 9228 3019
Our Reference:
Your Reference:

20 May 2011

Dear Ms Fox

IPSASB Consultation Paper: Conceptual Framework: Measurement of Assets and Liabilities in Financial Statements

New South Wales Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) in relation to the abovementioned Consultation paper. Detailed comments are attached.

While NSW Treasury supports development of the Conceptual Framework by both the IPSASB and International Accounting Standards Board (IASB), we strongly recommend that the IPSASB does not progress the IPSASB Measurement Consultation Paper (CP) until the IASB / Financial Accounting Standards Board (FASB) Conceptual Framework Phase C Measurement is complete. We strongly believe that a CP on the measurement of assets and liabilities is best first undertaken by the IASB. The IPSASB should then determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

We note that "the development of the IPSASB Conceptual Framework is not an IFRS convergence project", but that the IPSASB is "closely monitoring the development of the IASB's Conceptual Framework". However, the reason for not treating this as an IFRS convergence project is not explained or supported. Therefore, we encourage the IPSASB to proceed consistent with its document *'Process for Reviewing and Modifying IASB Documents'* (October 2008).

NSW Treasury believes that the IPSASB should work closely with the IASB with the objective of maximising convergence between the two Frameworks and the Accounting Standards. To do otherwise will invariably increase the risk of creating a wedge between the two Frameworks and resulting accounting standards, that will become increasingly difficult to reduce and even more difficult to eliminate.

Further, we believe that maximum convergence between the IPSASB and IASB is in the interests of the integrity of the accounting profession and the usefulness of its accounting standards in the global economy. Any action that increases the risk of unnecessary divergence should be avoided.

NSW Treasury is also concerned that the CP Executive Summary envisages "that the IPSASB Framework will identify factors that should be considered in choosing the measurement basis to be required for *particular* assets and liabilities in specific circumstances" (italics added) (para 1.5). The CP does not adequately explain or demonstrate why the IPSASB reached this conclusion rather than trying to identify a single measurement basis that is appropriate in all circumstances. Instead, the CP signals to a reader that the conclusion will be argued for, instead of rigorously evaluating the alternatives. It also presumes that a mixed measurement will continue.

We believe that the objective of a Framework document should be to conclude on a single measurement basis, even if this is only as an ideal that can only be achieved in certain circumstances, for example, where there is an active market. This can be attempted by critically evaluating each alternative measurement basis against the objectives of financial reporting and the qualitative criteria for information to be useful for decision-making. In this regard, NSW Treasury is concerned that even if the limited scope of the CP is accepted (i.e. based on measurement for particular assets / liabilities), the CP does not critically evaluate each measurement basis, in a structured and rigorous manner. Therefore, we do not believe that the CP is sufficient to satisfy its stated objective.

In addition, we note that the concept of capital is mentioned and linked to measurement bases. However, the concept of capital is not fully explained as being a driver of measurement bases, which therefore undermines the likelihood of reaching a valid conclusion on a desirable measurement basis.

Finally, in NSW Treasury's view, we believe that the CP is difficult to follow, as it mixes terminologies and confuses features, measurement bases, valuation techniques and proxies (e.g. market value versus fair value; replacement cost vs market value). Given this, we do not believe that the CP can reach valid conclusions.

These overarching comments are repeated in the following responses to the specific matters for comment as relevant to each question asked.

If you have any queries regarding the above and the attached comments, please contact me on +612 9228 3019.

Yours faithfully



Robert Williams
for Acting Secretary

IPSASB Consultation Paper: Conceptual Framework:
Measurement of Assets and Liabilities in Financial Statements
NSW Treasury comments

Specific Matter for Comment 1

Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

As discussed in the covering letter, NSW Treasury has serious concerns that the CP Executive Summary envisages "that the IPSASB Framework will identify factors that should be considered in choosing the measurement basis to be required for particular assets and liabilities in specific circumstances" (para 1.5). This therefore presumes that mixed measurement will continue. However, no reasoned argument for this vision is demonstrated or explained. Instead, it signals to the reader a conclusion has been made (i.e. to identify factors in choosing the measurement bases for *particular* assets and liabilities), that will be argued for, instead of rigorously evaluating the merits of alternative views.

Conversely, we believe that the objective of a Framework document should be to conclude on a single ideal measurement basis, even if this is an ideal that can only be fully achieved in certain circumstances, for example, in an active market. This can be attempted by critically evaluating each alternative measurement basis against the objectives of financial reporting and the qualitative criteria for information to be useful for decision-making.

The CP very briefly refers to the objective of financial reporting for accountability and decision-making and the qualitative characteristics of information (refer paras 1.15 to 1.18). It then very briefly discusses historical cost, market value and replacement cost. This is followed by a lengthy discussion of deprival value in a separate chapter. We are therefore concerned that the CP does not critically evaluate each measurement basis against the relevant qualitative criteria (which are noted at para 1.18) in a rigorous and structured manner. Therefore, even if the limited scope of the CP is accepted, we do not believe that the draft is sufficient to choose a preferred model.

The fact that, in practice, substitutes or proxies may need to be obtained for a measurement basis (and in individual accounting standards) does not deny that the ideal can be articulated. To simply state that "there is no single measurement basis that is appropriate in all circumstances" (para 1.5) misses the point of a Framework document, which should be conceptual in nature and which should attempt to outline an ideal.

Further, articulating an ideal measurement model in the Framework should not preclude also including guidance that may assist in choosing between measurement bases in specific circumstances, in the absence of being able to apply a single measurement basis. This would at least allow for the development of an improved mixed measurement model, as a precursor to applying an ideal model in all circumstances.

In selecting the ideal measurement basis, we also believe that the IPSASB should start with, or at least include, a rigorous evaluation of the various concepts of capital, which can be seen as the driver of the different measurement bases.

However, as discussed in the covering letter, we nevertheless believe that this analysis is best first undertaken by the IASB. The IPSASB's role should be to determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

NSW Treasury also notes that the CP states that "...it is desirable for the measurement bases used in financial statements to be consistent with those used for statistical purposes" (para 1.2). Further, the IPSASB's 'At a Glance' publication of December 2010, more strongly states that "the IPSASB is committed to minimising divergence from the statistical financial reporting models." We are concerned that the IPSASB makes such statements, without any justification and without similarly stating that it is desirable for the IPSASB measurement bases to be consistent, to the maximum extent possible, with those used by the IASB.

Similarly, we find it concerning that the CP refers to the IVSC definition of market value (refer para 3.2 of the CP), but does not include reference to the definition of fair value in the academic literature and IASB framework and accounting standards.

Specific Matter for Comment 2

If in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?

Single measurement bases
- *(a) Historical cost*
- *(b) Market value*
- *(c) Replacement cost*

Combinations of Bases/Approach
- *(d) Deprival value*
- *(e) Historical cost and market value*
- *(f) Replacement cost and market value*
- *(g) Historical cost, replacement cost and market value*

Others
- *(h) Another measurement basis or combination of bases / approach*

Please explain why you support a particular measurement basis or combination of measurement bases/ approach and your reasons for rejecting alternatives.

As stated under Specific Matter for Comment 1, we believe that the objective of a Framework document should be to conclude on a single ideal measurement base, even if this is an ideal that can only be fully achieved in certain circumstances, for example, an active market.

In broad terms, we believe there are two main measurement bases: current value and other than current value. We believe that, ideally, the single measurement base should be based on a current value, because current values are more relevant to evaluating and making economic decisions. Within these two measurement bases, there are a number of different measurement approaches, which may or may not be separate measurement bases in their own right. For example:

- Current value includes current market exit price and current market entry price (referred to as 'fair value' in IFRS 13).
- Other than current value includes adjusted past entry prices (sometimes referred to as historic cost).

From the current value bases, we believe that the ideal should be fair value. Market value or fair value is the most widely discussed / used current value model in the existing Accounting Standards, academic literature and the valuation profession. In this regard, we believe that the CP needs to discuss IFRS 13 *Fair Value Measurement*, which defines 'fair value' as an exit price. IFRS 13 is based on the view that a current entry price and a current exit price will be equal when they relate to the same asset or liability on the same date in the same form in the same market (IFRS13, BC44).

In contrast, however, NSW Treasury is concerned at the disproportionate focus given in the CP to deprival value. We particularly note the assertions in the CP that:

- deprival value "provides a rationale by which a specific basis may be selected as the most relevant in specific circumstances" (para 5.2) and
- deprival value "ensures that appropriate consideration is given to all the qualitative characteristics and the need to obtain an appropriate balance between them" (para 5.3).

In response, we believe that fair value, as articulated in accounting standards, does exactly the same as deprival value.

NSW Treasury believes that, in practice, there is no material difference between deprival value and fair value (or market value), as demonstrated in NSW Treasury's Policy Paper TPP 07-1 (refer extract attached as an Appendix to this submission). Therefore, we strongly question the benefit of the deprival value concept, which we view as merely an additional concept that over-complicates the measurement basis.

Finally, we note that IFRS 13 adopts a different solution to the problem of an ideal versus what is the most relevant basis in specific circumstances. Instead of alternative bases of measurement, it outlines a fair value hierarchy of alternative inputs. We strongly believe that a CP on measurement should acknowledge and rigorously evaluate the IFRS 13 approach to measuring assets and liabilities.

Specific Matter for Comment 3

The Consultation Paper discusses the following measurement bases: historical cost, market value and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

In NSW Treasury's view, the discussion in the CP on the measurement bases is not complete, balanced or fair, for the following reasons.

The discussion is not complete in many respects

First, as discussed in Specific Matter for Comment 1, the CP does not rigorously and critically evaluate each measurement basis against the objectives of financial reporting and qualitative characteristics and cost constraints, in a structured, rigorous and consistent manner. The consequence is that the discussion is not complete.

The incomplete nature of the discussion is illustrated by the IPSASB's rejection of a single measurement basis. The fact that, in practice, substitutes or proxies may need to be obtained for a measurement basis (and in individual accounting standards) does not deny that the ideal can be articulated. To simply state that "there is no single measurement basis that is appropriate in all circumstances" (para 1.5) misses the purpose of a Framework document.

Further, articulating the ideal measurement model in the Framework should not preclude including guidance that may assist in choosing between measurement bases in specific circumstances, in the absence of being able to apply a single measurement basis. However, even if the limited scope of the CP is accepted, we do not believe that the CP is sufficiently complete to choose a preferred basis for measurement (or approach).

Second, the CP does not sufficiently discuss the measurement of liabilities, except as part of deprival value which is not a separate measurement basis. The CP asserts merely that liabilities are unlikely to be measured at market value without adequate justification or explanation (para 3.14).

Third, the CP is not complete, because, although the concept of capital is mentioned and linked to measurement bases, the concept of capital is not fully explained as being both a driver of alternative measurements bases, and as a concept that can be seen as a criterion for choosing between alternative measurement bases.

The CP is also incomplete, as it does not discuss the following:

- The unit of account to be measured; i.e. it does not define what is the asset or liability to be measured, which will affect measurement.
- The valuation premise; i.e. whether the valuation is on a stand alone basis or through use in combination with other assets and liabilities.
- What is the appropriate market; i.e.:
    - Principal market
    - Most advantageous market
    - Wholesale vs Retail market.
- Fair value hierarchy, based on inputs.

The discussion is not balanced or fair

First, we believe that the discussion in the CP is not balanced or fair as deprival value is overemphasised. Conversely, the discussion of market value / fair value is very brief, even though it is the more widely accepted valuation methodology, and is materially no different from deprival value (refer Specific Matter for Comment 2). We do not accept that the discussion on deprival value needs more emphasis simply because it is not so well known.

Second, the discussion of deprival value is more an argument of why deprival value is better that the other approaches. It argues and concludes in the first three paragraphs that:

- deprival value is well established in the academic literature (para 5.1)
- deprival value "provides a rationale by which a specific basis may be selected as the most relevant in specific circumstances" (para 5.2) and
- deprival value "ensures that appropriate consideration is given to all the qualitative characteristics and the need to obtain an appropriate balance between them" (para 5.3).

Although the same benefits could equally be argued for fair value, in contrast, the discussion of market value / fair value briefly states that "in an ideal context, market value possesses all of the qualitative characteristics" (para 3.5). The majority of the balance of the brief three pages then questions the usefulness of market value in other than the ideal situation, including more than one page explicitly articulating its limitations. Conversely, the 10 page discussion of deprival value did not address or contemplate any of its limitations.

Instead, we believe that the CP should provide a balanced and fair comparison, including an equivalent evaluation of fair value / market value and other bases.

For illustration, the following approach to determining the appropriate financial reporting valuation method was proposed by Chambers in *'Accounting, Evaluation and Economic Behaviour'* (1966)). He asked the following questions:

- What property is to be measured; e.g. monetary measures based on present selling (exit) prices.
- What is the concept of capital, which he termed 'capital maintenance'
- What should be allowed in real world circumstances where the desired measurement basis cannot be reliably applied?

Chambers then argued that all measurements are only approximations; i.e. which, although suggesting an ideal, then accepts surrogates.

Third, we are concerned that the terminology used in the CP is confusing, as it uses concepts that are not mutually exclusive and mixes measurement bases, features and valuation techniques. The resulting conclusions make the CP neither fair nor balanced. For example:

- Market value (as used in Valuation Standards) is confused with fair value (as used in Accounting Standards).
- Valuation techniques (e.g. replacement cost) are confused with measurement bases (e.g. market value).
- Replacement cost is not necessarily an entity specific measure; i.e. DRC is a measure of fair value under Accounting Standards.
- Replacement cost is a subset of market value / fair value; i.e. replacement cost and market value are not mutually exclusive.
- Deprival value is not a measurement base; rather it is an approach to choose the measurement base.
- The CP refers to the IVSC definition of 'market value' but does not refer to the IFRS 13 definition of 'fair value'.

Fourth, the line of argument in the CP is not balanced as it refers to consistency with Government Finance Statistics (GFS), but does not consider consistency with IASB. No rationale is given as to why GFS is an important consideration in the Framework; nor why the IASB Framework is not. The IPSASB Framework presumably will apply at the whole of government level, sector level, and individual entity level. However, as a macro-economic concept, GFS does not apply at the microeconomic level i.e. the entity level.

Specific matter for Comment 4

In your view, should:

(a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and
(b) The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured.

NSW Treasury believes in principle that, where measurement is based on current values, it is appropriate to include own credit risk, both initially and subsequently. However, where the measurement is not based on current values then it is not appropriate to adjust for own credit risk.

However, this requires clarification as to what is regarded as a current value for a liability and when is it appropriate for it to be used. For example, it may not be possible or appropriate to measure the current value (or 'assumption price') of a liability where:

- the highest and best use is to settle rather than transfer the liability or
- there are no market participants.

In such cases, the settlement or cost of fulfilment may be appropriate; i.e. an entity specific measure which makes no reference to market variables such as profit margins or credit risk.

Specific matter for comment 5

In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:

(a) Only the service potential relating to the existing use; or
(b) Include the incremental value relating to its possible sale for an alternative use?

NSW Treasury supports the approach adopted in IFRS 13 based on the concept of 'highest and best use'. That is, current value or fair value is based on the highest and best use; i.e. the use of the asset that is physically possible, legally permissible and financially feasible. This principle is established in accounting standard literature, valuation profession literature and academic literature.

Highest and best use is more consistent with para (b) above (i.e. incremental value relating to possible sale for an alternative use), except that we believe it is more appropriate to reflect the value for the highest and best use as one value, rather than, as para (b) implies, based on two measures, the existing use value plus the incremental for an alternative use. We also note that, the IASB, in issuing IFRS 13, has moved away from the concept of an incremental value, which was originally proposed in their fair value Exposure Draft (ED, para 20 and 21).

APPENDIX 1

EXTRACT OF NSW TREASURY POLICY PAPER TPP 07-1 VALUATION OF PHYSICAL NON-CURRENT ASSETS AT FAIR VALUE

Comparison of fair value and deprival value

This Appendix compares fair value and deprival value. In the past, deprival value has been adopted by some Public Trading Enterprises, following the *Guidelines on Accounting Policy for Valuation of Assets of Government Trading Enterprises* (October 1994). That document adopted the guidance provided in Statement of Accounting Practice SAP 1 *Current Cost Accounting* regarding measuring replacement cost. This Policy and its pre- AEIFRS predecessor (TPP03-02) require entities to value certain physical non-current assets at replacement cost, effectively also using the guidance provided in SAP 1 *Current Cost Accounting*.

This Appendix notes the major differences between fair value in AASB 116, subject to AASB 136 and deprival value and assesses the practical implications of moving to fair value under this Policy.

Two major differences exist between fair value and deprival value:

- Theoretical difference between fair value and deprival value concepts.
- The use of market value in AASB 116 compared to the use of both market value and net market value in certain circumstances under deprival value.

These two differences are briefly discussed below.

1. Theoretical difference between fair value and deprival value

Fair value is based on market evidence - a willing buyer and seller. In effect, this is the 'exit' or selling price. The best available market evidence is used, but where current market prices cannot be observed, fair value in AASB 116 is measured at depreciated replacement cost, which is a market buying or entry price.

Deprival value is measured by reference to the loss suffered by an entity on being deprived of an asset (an entry price). The valuation is then determined depending on whether the entity would or would not replace the asset. In this sense, it is based on rational management intentions.

The difference between fair value and deprival value is the difference between selling price and buying price. However, where current market prices can be observed for the same or similar asset, market selling price and buying price will be approximately equal.

Conversely, where current market prices cannot be observed, market selling price and market buying price may differ significantly. Most proponents of exit market price allow market buying price to be used as a surrogate for market selling price. In this circumstance, AASB 116 and this Policy require fair value to be measured at depreciated replacement cost, which is a market buying price. AASB 116 does not acknowledge that market buying price is being used as a surrogate for selling price. It acknowledges, however, that this is the best available evidence of fair value where market (selling) prices cannot be observed (AASB 116, para 33).

2. Market value versus net market value

Deprival value requires surplus assets (i.e. assets held for sale without replacement) to be valued at net market value. In these circumstances, fair value (per AASB 116) and deprival value would differ by the incremental costs directly attributable to selling the asset.

This difference is largely eliminated by the operation of either AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* or AASB 136 *Impairment of Assets*, as follows.

- "Surplus assets" that meet the definition of "held for sale" in AASB 5 must be valued at the lower of its carrying amount and fair value *less costs to sell*.

- "Surplus assets" that do not meet the AASB 5 "held for sale" definition are subject to the recoverable amount test in AASB 136. The *recoverable amount* is defined as the higher of *net* fair value (i.e. fair value *less costs to sell*) and value in use.

3. Conclusion

NSW Treasury's conclusion from the above brief analysis is that there are no material practical differences between fair value and deprival value.



Government of Newfoundland and Labrador
Department of Finance
Office of the Comptroller General

June 15, 2011

Ms. Stephenie Fox, Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario
M5V 3H2

Dear Ms. Fox:

Re: IPSASB Consultation Paper (CP)-Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements (Phase III)

I offer the following comments to the Board on the Conceptual Framework Consultation Paper-*Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements* on behalf of the Provincial Government of Newfoundland and Labrador.

General Comments

It is our position that IPSASB's conceptual framework should reflect a single measurement basis and that basis should be historical cost. The proposals appear to suggest that the IPSASB has a preference toward identifying factors that should be considered in choosing a measurement basis for particular elements in specific circumstances, rather than identifying a single measurement basis. However, it is our view that financial statements that are prepared primarily using the historical cost basis of measurement more appropriately reflects the public sector. In this regard, while it is considered appropriate that a market value could be used in limited circumstances, it should reflect the essence of the Public Sector Accounting (PSA) Standards which indicates that "transactions and events are recognized in the financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place". Therefore, the measure of fair value or market value is in relation to determining an initial cost not a revaluing perspective.

A single measurement base that primarily reflects historical cost is more consistent with the nature of the environment in which Canadian governments and public sector entities operate. It is more easily understood by the user, it is more objective and easily verifiable and provides transparency and accountability of government reporting as it reflects cost of services. In fact, the relevance of market values for Canadian governments is questionable. Where assets are generally held for long periods of time (little speculative investing) the short term changes in value that are reported under this a market basis are not relevant to the entity's financial position or performance. As well, in order for a market value basis of measurement to be useful to the user and achieve the objectives of financial reporting, there is a requirement that a deep and liquid market should exist. From the perspective of governments, there are not always readily available markets, especially in relation to highly specialized assets. As market prices may not be available, market values would have to be estimated which reduces comparability, verifiability and understandability. For reasons provided, replacement cost and the deprival value model, which are based on current cost measurement, are not supported.

Further, there is no justification to report an amount in the statement of financial position that would include incremental value relating to an asset's possible sale for an alternative use. This does not provide information that is useful in the perspective of Canadian governments. Assets are generally held to provide services to the public and such decisions are not always made with a profit maximizing or a return perspective. In any regard, the financial statements should be presented to reflect the intent and purpose of management and in a manner that can be understood and relevant to the primary user.

Thank you for the opportunity to provide my comments on this issue. If you require further information, please contact myself or Carmalea Gillingham, Accounting Research Specialist, at (709) 729-4049.

Yours truly,

RONALD A. WILLIAMS, CA
Comptroller General of Finance

cc: Terry Paddon, Deputy Minister of Finance