

## Agenda Item 4B: Conceptual Framework: Measurement

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IPSASB Meeting

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Toronto, Canada

# Objectives of Sessions/Materials

- a) To discuss a further analysis of responses to CF–ED3, *Measurement of Assets and Liabilities in Financial Statements*, supported by revised collation and summary
- b) To reaffirm or modify tentative decisions at the June meeting and provide directions for development of a first draft of a final chapter; and
- c) To identify issues for further analysis.

## Materials Presented:

- 2A.1 Issues paper
- 2A.2 List of respondents/collation with staff views
- 2A.3 Analysis of respondents–region, function & language
- 2A.4 Responses to CF–ED3 (previously circulated and on website)

## Background: Paragraph 3

- CF–ED3 issued November 2012
- Consultation period until April 30, 2013
- 39 responses (Responses 38 & 39 not considered at June meeting)
  - Only minor changes in staff comments on Responses 1-37 in Agenda Item 4B.2 Collation and Summary

## Respondents 38 & 39: Paragraphs 5-8 (1)

- Highly critical of proposals but different perspectives
- Respondent 038
  - Supports approach to evaluation of measurement bases but
  - Measurement bases for assets and liabilities can be simplified
    - Questions net selling price (assets), assumption price & cost of release (liabilities)
  - View that discussion of historical cost unbalanced and favors replacement cost for cost of services
  - *Staff: Amend core text and Basis for Conclusions to reflect points*

## Respondents 38 & 39: Paragraphs 5-8 (2)

- Respondent 039
  - Framework should be aspirational
  - Rejection of failure to prescribe single measurement basis
  - Need for measurement objective underpinned by ideal concept of capital rather than reliance on reporting objective
  - Omission of fair value a serious defect

Matters for Consideration: (1) *Is summary of these respondents fair?*  
(2) *At this point does IPSASB wish to modify any initial tentative decisions?*

# Measurement Objective: Paragraphs 9-16 (1)

- CF–ED 3 Approach
  - No specific measurement objective
  - Selection of measurement basis related to objectives of fin. reporting
  - Uncontroversial proposal and large majority fully or partially supported
    - Support sometimes qualified with call for measurement objective
  - Minority of respondents oppose
    - Support for objective in AV
    - Historical cost should be primary basis
    - Reference to prudence in objective

## Measurement Objective: Paragraphs 9-16 (2)

- Objective based on concept of capital: Respondent 039
  - Invested money capital (?)
  - Current cash equivalents
  - Operating capability
- Operating capability
  - *An entity's operating capability and its ability, at any given time, to carry out its activities at the scale determined by its then-existing resources*
- *Staff view: Highly relevant but would involve virtually explicit assertion that current cost measures are superior to historical cost. Not feasible unless view of historical cost is revised.*

## Measurement Objective: Paragraphs 9-16 (3)

- Direction to develop measurement objective based on AV objective
  - *To select those measurement attributes that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.*
- Staff view that too aligned to current value
- TBG view that reference to “cost of services” provides link to historical cost depending on interpretation of accountability objective
- *Matter for consideration: Is AV measurement objective appropriate. If not, how should it be modified?*



# Current Value Measurement Bases: Paragraphs 17-32 (1)

- Proposed measurement bases in Section 3 of CF–ED 3 :
  - Market Value
  - Replacement cost
  - Net selling price
  - Value in use
- Respondents' views
  - Under half with view fully supportive
  - Just under 20% partially supportive: e.g. supportive of historical cost
  - Over a third opposed: reasons include omission of fair value, replacement cost, historical cost more appropriate than current values

# Current Value Measurement Bases: Paragraphs 17-32 (2)

- Most contentious issues:
  1. Omission of fair value
  2. Replacement cost as measurement basis in own right rather than valuation technique for fair value
  3. Net selling price

*Matter for consideration: Are these the main issues related to current value for assets?*

# Current Value Measurement Bases: Paragraphs 17-32 (3)

## Fair Value (1): Approach & Definitions

### Rationale for not proposing as measurement basis

- I. Market value and fair value similar if not same
- II. IFRS 13 definition an exit value: *The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*

- Current IPSAS definition of fair value (similar to proposed MV defn):
  - *The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (at the reporting date)*
- IASB Discussion Paper acknowledges exit/entry values
  - Exit price when asset held for sale
  - Entry price for assets held for use or when exit prices unavailable or no orderly transactions

# Current Value Measurement Bases: Paragraphs 17-32 (4)

## Fair value (2): Options for Framework

- i. Adopt IFRS definition
  - Not aligned with objectives of many public sector entities
  - Convergence/alignment more straightforward
- ii. Retain current definition
  - Different definitions of same term by global standard setters
- iii. Define market value rather than fair value
  - Implications for current literature (IPSAS 12, IPSAS 16, IPSAS 17, IPSAS 27)

*Matter for Consideration: Should approach in ED be retained?*

# Current Value Measurement Bases: Paragraphs 17-32 (5)

## Replacement Cost

- Main technical objections
  - i. Complexity and subjective entity specific
  - ii. Difficulties of obtaining market-based evidence exaggerated
  - iii. “Highest and best” approach provides more useful information
- Relevance
- Operational assets where market open, active and orderly
- Appropriateness of highest & best value when no intention to sell

# Current Value Measurement Bases: Paragraphs 17-32 (6)

## Net Selling Price

- Is net selling price entity specific?
- Is it sufficiently distinct from market value/fair value to be retained as measurement basis in own right?
- *Staff View: Will reflect market-based evidence, but reflects immediate exit and no assumption of open, active and orderly market. Retain*

## Matters for Consideration

- *Confirm four current value measurement bases for assets in CF–ED3*
- *Agree to relax view in CF–ED3 that all operational assets measured at replacement cost*

# Fair Value Measurement Model: Paragraphs 33-35 (1)

- Method of determining market value where appropriate basis, but market, inactive or not open or orderly
- Under a third of respondents with view fully supportive
- Partial support from just over a third
  - View that model too low level
- Over a third opposed
  - Many supported fair value as measurement basis

# Fair Value Measurement Model: Paragraphs 33-35 (2)

- Staff Views
  - Omission of fair value but inclusion of fair value model confusing
  - Agree that too low level for Framework
  - Use some of the material in paragraphs 4.6 and 4.7 in section 3
- *Matter for consideration: Confirm view that fair value model should not be retained in final chapter and relocation of some material in paragraphs 6 & 7 to Section 3*



## Deprival Value Model: Paragraphs 36-39 (1)

- Selection of measurement basis primarily by evaluating extent to which it contributes to objectives of financial reporting and meets the QCs
- Deprival value model to select or confirm use of current measurement basis

## Deprival Value Model (2): Paragraphs 36-39

- Quarter of respondents with view supportive
  - Little supporting rationale
- Under 20% partially supportive
  - Generally no technical issues but Framework should not prescribe detailed models

## Deprival Value Model (3): Paragraphs 36-39

- Over half opposed
  - Cost and complexity main reason
  - Technical issues highlighted in June
    - Hypothetical assessments of replacement cost
    - Unreliable estimates of depreciation
    - Open to manipulation
    - Relationship when net selling price > replacement cost
    - Should be included in Section 3 because replacement cost inappropriate without a recoverability test

## Liabilities: Paragraphs 40-43 (1)

- Five measurement bases proposed:
  - Historical cost
  - Market value
  - Cost of release
  - Assumption price
  - Cost of fulfillment

## Liabilities: Paragraphs 40-43 (2)

- Just under half with view supported proposed measurement bases
  - Discussion of transfer of liability in context of cost of release more related to recognition than measurement: *Staff agrees: revise wording*
- Just over a quarter partially supported
  - General support but disagrees with omission of fair value: *Staff view same rationale as for assets*
  - Distinction between market value and cost of release unclear: *Staff view that cost of release an immediate exit not dependent on orderly, open and active market*

## Liabilities: Paragraphs 40-43 (3)

- Just under a quarter in disagreement
  - Omission of fair value and advocacy of IFRS 13 definition
  - Inconsistency of discussion in paragraph 5.6 with definition of market value in section 3: *Staff view retain substance of definition in section 3 (settlement rather than transfer, but standalone definition for liabilities)*
  - Reservations about cost of release and assumption price in public sector context: *Staff View: Cost of release and assumption price unlikely to be appropriate or feasible in many public sector circumstances. Already a reference to this in Basis for Conclusions-retain*

## Liabilities: Paragraphs 40-43 (4)

- *Matter for Consideration: Should the measurement bases for liabilities in CF–ED3 be retained in final chapter?*

## Other Issues: Paragraphs 44-47

- Valuation of assets on standalone basis or on basis that used with other assets
- Income based present value approaches
  - Valuation technique converting future cash flows to discounted amount
  - Appropriateness for market value where market inactive or otherwise not open or orderly
- Other cash flow-based measures
  - Non current value measurement methods based on estimated cash flows
  - E.g provisions, post-employment benefit liabilities, impairments



## Structure of Final Chapter: Paragraph 48

1. Introduction
  2. Historical Cost
  3. Current Value Measurement Bases for Assets
  4. Measurement Bases for Liabilities
- Basis for Conclusions

*Matter for Consideration: Is proposed structure appropriate?*

## Way Forward

- First draft of final Chapter at December meeting



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